THE ELEMENTS

OF

PUBLIC FINANCE

INCLUDING

THE MONETARY SYSTEM OF THE UNITED STATES

BY

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TO

Charles W. McAlpin

WITH TRUE REGARD

PREFACE.

THE present volume owes its origin to the want the author experienced in finding a suitable text for his classes. Such treatises as were at hand proved unsuitable for one or the other of two very different reasons. Either their treatment of financial theory was too detailed, or the scope they allowed to public finance was too narrow to include certain subjects—such as our currency system—which I thought fit to discuss in a somewhat practical manual.

So manifold are the obligations I am under to various writers on finance that I shall make no attempt to enumerate them all in this place. I have indicated in the footnotes the sources from which I have drawn much of my material, and have added, here and there, an appreciative comment. It would be unfair, however, not to mention the great assistance I have derived from the writings of Bastable, Seligman, and H. C Adams. The latter's *Science of Finance* had not issued from the press when my manuscript went to the printer, and consequently I have been able to insert only a few cross-references to this excellent work while correcting my proofs. I am under special obligations to my friend, Professor Stockton Axson, for his kindly and valuable assistance in reading the proof.

W. M. D.

PRINCETON, May 15, 1899.

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INTRODUCTION.

I.

The Definition of Public Finance.—No little ingenuity has been expended by philosophical jurists to imprison "within the ring fence of a restrictive definition" the essence of government. Not infrequently these definitions appear to the ordinary inquirer as 'hypostatized abstractions,'—adequate perhaps to purposes of political theory, but foreign to the every-day experience of the market-place. It is not surprising, therefore, that attempts have been made to define government in terms which, if lacking in philosophic comprehensiveness, are at least capable of being tried by the facts of actual civic life. "Whatever else it may be," says Mr. John Fiske,[1] "the government is the power which taxes. . . . If we are in any doubt as to what is really the government of some particular country, we cannot do better than to observe what person or persons in that country are clothed with authority to tax the people." Ruskin[2] sounds much the same note where he dubs the 'thing' called a 'government' "an apparatus for collecting and

[1] Civil Government in the United States, p. 7.
[2] Fors Clavigera, III., p. 237.

spending money." These rough-and-ready descriptions of government may not exhaust its significance, but they do emphasize the most common, perhaps the most characteristic, feature of this political entity. The collection and expenditure of money is, of course, not so much the end of government, as the means whereby it accomplishes its ultimate purposes. The study of this essential prerequisite to all governmental activity is the domain of Public Finance.

Public Finance,[1] therefore, we may define as the study of the collection and expenditure of funds legally devoted to public ends. It will naturally embrace the most prominent effects, political and economic, which result from the exercise of this all-important governmental function. This definition recognizes the coercive character of revenue collection and expenditure. This does not imply that personal unwillingness on the part of the subject always attends upon financial adminstration, but indicates that the field of public finance lies wholly within the domain of positive law, and

[1] The word finance comes from the Latin *finis*, through two mediæval derivatives, *finatio* and *financia*. These latter by metonymy (where the period of indebtedness was used for the debt itself) meant the payment of indebtedness, and are analogous to the early use of our English word *fine*. In the sixteenth century finance was used synonymously with money in France, while in Germany the word finance fell into bad philological company and became equivalent to extortion. See Schönberg, Handbuch der Pol. Oek., III., p. 7. Finance is used to-day in English with no little latitude in meaning It is sometimes used either alone or in connection with some other term to cover the monetary, commercial, or industrial sphere. Mr. Giffen entitles his shorter miscellaneous writings Essays in Finance. When finance is qualified by the term public there can be little question as to its exact connotation. It is worthy of note that finance is used both in the singular and in the plural. Used in the singular it not infrequently denotes the art of financial management, whereas the plural generally applies to the state of a nation's resources.

excludes purely voluntary contributions or payments, such as public subscriptions, for example, or contracts between private individuals or corporations.

Practical Bearings of Public Finance.—The objection has been urged to formal and systematic treatises on finance that finance is essentially an art, that it is not subject to rule and precept, that success in this sphere cannot be taught, and that the financier, like the poet, is born, not made. There is in this a trace of truth. There were eminent financiers before finance was ever regarded as a science. Moreover, the mere study of the general principles of the science can no more make a great financier than the mere study of politics can create a Bismarck. At the same time there is a well established body of facts, economic and financial, which go far to equip the statesman for dealing with questions of a financial nature. Not only have many of the most famous financiers been careful students of the general theory of finance, but they have frequently enriched the theory itself. Turgot and Peel are instances in point. Our chief need to-day, however, is not to equip financial experts, but to instruct public opinion. It is necessary to dissipate the idea that finance is a matter of occult fortune or clever juggling. It is essential that a self-governing people should understand that there are certain well ascertained and comparatively simply principles to which financial legislation and practice must conform, unless disaster is deliberately invited. "Finance," as M. Leroy-Beaulieu says, "has a terrible fashion of avenging itself upon governments by whom it is ignored or defied."[1]

Even when it is admitted that there is a sufficient basis of fact upon which financial generalizations may be built,

[1] Science des Finances, I., preface to the fifth edition, p. viii.

there prevails not infrequently the impression that at best the subject is largely devoid of interest. The field has no attraction for the general public. An old adage has associated death and taxes in their quality of certain recurrence, and most people try to think as little of the one as of the other. Taxes are commonly thought to be the most dismal part of 'the dismal science,' and the trail of statistics is over them all.

And yet finance is not lacking in practical or theoretical interest. It is preeminently one of the things that "come home to men's business and bosoms." Consider first the bearing of finance upon the income of the individual citizen. Mr. Robert Luce in an essay[1] upon this subject says: "It can be proved that the average American citizen works one month out of the year for the sake of being governed. In other words, taxation takes one twelfth of his earnings. This average American is the head of a family of five persons, earning a thousand dollars a year. He pays thirty of this into the national treasury, thirty into the state, county, city, or town treasury, and at a moderate estimate twenty-three dollars more for the indirect cost of collection. The total, equal to one month's earnings, does not affect the question of the equitable distribution of the burden, but emphatically shows the importance of the question." We are not here concerned with the exactness of this estimate nor with the data on which it is based. But granting it to be approximately true, it emphasizes the significance of an understanding of public finance for the taxpayer.

M. Leroy-Beaulieu has undertaken an estimate of the part of the income of the nation which is absorbed by taxation in certain countries of Europe. He finds that in Belgium taxes take from six to six and a half per cent.

[1] Public Opinion, 1892, p. 51.

of the public income; in England, seven and three quarters per cent.; in France, eleven per cent.; and in Italy, fifteen or sixteen per cent.[1] Let the importance of financial legislation and administration be thus brought home more directly to the taxpayer, and the subject will be invested with far greater importance than it now obtains.

Theoretical Bearings of Public Finance.—Not alone for the man of affairs does the study of finance have a controlling interest. The historian and the sociologist can ill afford to dispense with its study. This is very commonly recognized in the domain of historical investigation. A fairly definite insight into the life of any period must include some knowledge of the social distinctions in which the financial system was rooted, and which in turn it helped to perpetuate.

The student of constitutional liberty does not need to be told of the dominant rôle played by financial issues in modern politics. These issues have been not only the unfailing source of party strife; they have been as well the formative influences in constitutional growth.

But aside from the purely historical import of the subject, finance has for the acute observer of shifting social currents an interest not inferior to that excited by any other social movement. The lines of social cleavage run to-day substantially parallel with lines of wealth. Those, moreover, who regard the present economic constitution of society as evil are only too apt to look upon the tax power as the readiest implement of reform. The inequalities of the law of competition they would correct by the equity of expropriation. This employment of the tax power may possibly be justified up to a certain limit. The governmental assumption of certain natural monop-

[1] Science des Finances, I., p. 133.

olies may be warranted upon grounds of public utility.[1] But thoroughgoing Socialism or Collectivism would probably deny that any limit upon the tax power is justifiable which stops short of the proximate realization of their distributive ideal. It is right here that the sociological side of finance becomes of prime importance. The present constitution of private property has been challenged. Whether this institution can or ought to be changed; if so, to what degree; whether the distribution of the social dividend can be effected upon another basis than the present one;—these are the points of contact between Collectivism and the industrial constitution of modern society. In short, the battle-field where Socialism will not improbably assail the conservative forces of society lies within the domain of finance. Thus its study acquires a larger scope and affords a more extended outlook. It remains no longer the mere technique of tax collection and expenditure, but joins the theoretical moral and political sciences, and extends its speculations beyond the world of the Present into the society of the Future.

Relation to Cognate Disciplines.—There are two roads by which the study of finance may be approached—through the province of Political Economy or through that of Law.[2] The first is the English method; the latter is the method of the typical German publicist. If the former be adopted, finance will be classed as a branch of applied Economics. If the latter alternative be chosen, finance will be viewed as a department of Administration. This divergence in classification illustrates the different

[1] Cf. Sidgwick, Principles of Political Economy, p. 408; also Hadley, Economics, p. 397 *sq.*

[2] Cf. Bastable, Public Finance, p. 7. (*Note.*—All references to Bastable's Public Finance are to the second edition.)

historical origin and development of the science in the two countries. Self-government in England involved the necessity of a popularly evolved and approved system of taxation. Hence the necessity of an economic justification of legislation which affected the taxpayer's purse. In Germany, on the contrary, the power of the Crown has imposed from above a financial régime upon the subject; and in consequence the perfecting of administrative machinery was the task of the beaurocracy. Adam Smith typifies the English view, as Stein represents the German conception of the subject. Whichever classification be adopted for the sake of convenience in the logical distribution of the content of knowledge, there can be no essential difference of opinion as to the relation of cognate sciences to the science of Finance. To adapt the abstract formulæ of theory to given conditions the fullest historical knowledge of the concrete conditions is necessary. Statistical data when accessible are as indispensable here as elsewhere in the domain of practical politics. Economics must largely furnish the premises wherever the effect of financial action upon material welfare is involved; and Ethics must not infrequently constitute the court of final appeal where issues of justice and social duty arise.

II.

THE HISTORICAL DEVELOPMENT OF FINANCE.

The Modern Financial Constitution. — An economic system varying endlessly in non-essentials, but identical in its general outlines, is to be found in every advanced industrial nation of to-day. This system has been

variously named and described. Perhaps the term Factory System, while not entirely unobjectionable, is as adequate a title as has been suggested. It covers, however, but one side of modern economic life. We may use the term, nevertheless, to connote the universal features of the industrial constitution of the present. These invariably recurring characteristics may be summed up in Prof. Marshall's phrase 'Freedom of Industry and Enterprise.'[1] This is, however, only the subjective side of the matter, and serves chiefly to contrast it with the restrictive features of an earlier economic era.

The objective side of this system cannot be portrayed in a single phrase, but it may be provisionally described as embracing the modern productive process, with its vast and complex aggregate of capital, directed by the captains of industry, each commanding his battalion of the industrial army. It is prosecuted under a régime of minutely specialized employment, and it involves to an incredible extent the delicate yet effective application of credit. All this necessitates numberless social adaptations, of which the concentration of population into cities and the perfecting of transportation facilities are perhaps the most prominent. Such, in briefest detail, is the industrial system with which we are to-day familiar. Whatever be its permanence or merit is not here the question. Friend and foe are at one, however, in the description given of its general features. But the point to be insisted upon is this, that analogous to this economic system we find in all these nations, with countless varieties in detail, it is true, a substantially identical system of public finance which we may term the modern financial constitution. The general outline

[1] Principles of Economics, Third Edition, Vol. I., p. 8.

of this system of finance must first be set forth, and its historical development must then be reviewed.

The first characteristic feature to be noted is *the normal and calculable field of governmental activity.* When war is the normal state of affairs, or where war is so frequent as to preclude the assumption of undisturbed industry for any considerable length of time, prevision as to governmental expenditure is largely impossible. It is only when the transition has been made from 'militarism' to 'industrialism,' to use Mr. Spencer's terms, that reasonably accurate prevision can be made as to the probable expenditure of the government. It needs no extensive acquaintance with history to see that the present is in general an era of peace as compared with previous centuries. Universal disarmament, it is true, seems very largely a utopian ideal, perhaps an 'iridescent dream.' Universal international arbitration also may have long to wait for its perfect realization, but fortunately our century has not been in the main one of 'wars and rumors of war.' We normally assume that the coming year will be one of peace, or at worst a continuation of an armed neutrality; and on the basis of this assumption we predict the immediate future of the state's financial activity. Statistics, it is true, afford us the immediate data for our calculation, but these very statistics depend largely for their validity upon the continuance of those peaceful conditions which prevailed while they were collected. Politics, it is safe to predict, will never become an exact science in the degree that certain of the physical sciences are said to be exact. But when, as has sometimes happened, a finance minister can predict for the coming year both expenditures and receipts within a fraction of one per cent., in a total of hundreds of millions, the degree of quantitative precision

required to constitute an exact science does not seem to be altogether unattainable.

The second distinctive feature of the modern financial constitution is *the periodic exaction of money from citizens for the support of the state.* This conception seems to us moderns natural and indeed inevitable. The fact is that this annually enforced exaction of money from citizens is historically of comparatively recent origin. In times of classical antiquity the natural assumption was that the citizen ought not to be expected to pay taxes. The citizen was the beneficiary of the state, not its financial support. Revenue came from those who were *not* citizens, from subject allies or conquered dependencies. "Of whom," said our Lord, "do the kings of the earth take tribute? of their children or of strangers?"[1] And the answer "Of strangers" came as naturally as though this were a first axiom of political philosophy. Such indeed it then was. Originally, then, the citizen was not 'taxed' at all,—at least in the modern sense of the term. Even when taxes as we know them had been definitely instituted, their very names not infrequently show that they were in a sense voluntary offerings or contributions rather than legal exactions. Thus in early English history taxes were called 'grants,' 'aids,' 'benevolences,' 'subsidies.'[2] Moreover, when taxes were exacted from the citizen as a matter of legal right, such exactions originally were not regularly recurrent, but occasional. They were imposed not annually, but upon the occasion of pressing need. They were regarded as tiding the government over some special exigency or danger, and were at first sometimes repaid. In all these particulars taxation, as we know it, is distinctly a new historical product.

[1] Matt. 17 : 25.

[2] Cf. Ely, Taxation in American States and Cities, p. 37, for an American parallel.

Thirdly, *popular control over public income and expenditure* is another mark of the modern financial system. Modern finance is as new as modern representative government. Constitutionalism itself is, as Prof. H. C. Adams[1] remarks, essentially the control over the public purse by the property-owning classes. This implies, of course, that these classes exert through their representatives, or in spite of them, a substantial control over taxation and expenditure. This is in large part the substance of political liberty as known to English history. To be sure it frequently masks under the guise of Equality or other political cloaks. It uses now this political watchword and now that, but its design has been always the same. The English Revolution of 1688 was, in fact, but the registration of the supremacy of the commercial and industrial order. Modern democracy has indeed operated at times to restrain the open avowal of this purpose that the Haves, not the Have-nots, shall control the purse, and has even succeeded now and then in setting it at naught. But the principle still persists, though it finds its defence largely in constitutional limitations upon the spending powers of extravagant legislatures[2] or in judicial vetoes upon measures menacing the rights of property.

Lastly, *the universality of public credit* must be reckoned among the noteworthy attributes of the financial constitution of to-day. The significance of the late rise of public credit and of its extension parallel with the growth of the political power of the propertied classes consists in the fact that "when property owners lend to the government they lend to a corporation controlled by themselves."[3] Public debts are in reality mortgages upon

[1] Public Debts, p. 8.
[2] Cf. Bryce, American Commonwealth, Ch. XLIII.
[3] H. C. Adams, Public Debts, p. 9.

all the industries under the taxing power of the debtor government. The interest on these debts ordinarily can be paid only by taxation. Some substantial security against repudiation is a condition necessarily precedent to the employment of public credit; and this security originated and consists in the political power of the propertied classes. Hence the origin of this last characteristic of modern public finance.

Financial Systems of Classical Antiquity.—That the uniform features of the financial constitution of modern states are no historical accident needs hardly to be proved. But to show exactly how the modern system came to be what it is, and the better to understand its unique nature, it will be useful to understand in broad outline the financial régimes of other and earlier times. The first political experiments worthy of study on the part of us moderns are those of the city-states in Greece, especially those of Athens. Here as elsewhere the question of securing material support for the state depended in great part upon the economic and political environment. The growth of industry was hampered by various causes. The institution of slavery, itself the outcome of war, created a subject class frequently more numerous than their masters. To this class most industrial pursuits were relegated. Thus a social odium was attached to labor, and consequently the energy of the ruling caste was largely diverted from industrial channels.[1] The division of labor was but rudimentary. The family organization of industry largely prevailed. This involved the cultivation of agricultural estates by means of slave labor, and the fabrication of goods for the use of the family, including the slaves and dependents of the ruler of the household. The main outlet for commercial

[1] Ingram, History of Political Economy, p. 11.

enterprise was foreign commerce, for which the Greeks were famous. But the trading and industrial spirit did not flourish until the times of decadence, and was viewed askance by the most enlightened minds of that day. Upon such an economic basis no enduring financial superstructure could be built. The springs of modern revenue are to be found in modern industry. To this there was no counterpart in Greece. Revenue therefore came primarily from tribute. The Confederacy of Delos, for example, of which Athens was nominally the president but really the master, furnished about sixty per cent. of the city's revenue. The rental of state lands and mines—especially the silver mines of Sunion—together with port dues and court fines furnished the residue. The *liturgies,* which were nominally voluntary contributions made by wealthy citizens to provide for the city public games and spectacles, were in reality exactions upon the rich enforced by the ever impending social sanction of Ostracism. But no regular taxes were laid in Athens until after the Peloponnesian war, when the true Athenian spirit had largely decayed.

Rome repeats in large measure the story of Athenian finance, except on a broader scale. In Rome the seeds of slavery were implanted at the time of the earliest conquests over neighboring states. The free peasantry, which had originally been the bulwark of the Roman state, gradually disappeared. The severity of the military service, coupled with the largesses of corn imported from tributary provinces, led to the sale and the subsequent unification of the small Italian farms, and transformed the free peasantry into the proletariat of the capital. Nor did industry or navigation have for the Latins the attractions they had for the Greeks. "Industry, commerce, and navigation were mostly in the

hands of strangers. The Italians themselves had no natural liking or aptitude for those pursuits which were the delight and glory of the Greeks, the Etruscans, and the Carthaginians. Nor was this the case only in the period of their earlier antiquity. The same habits prevailed when the city of Rome had become the centre of a power that ruled the world." [1] In Rome, therefore, revenue came mainly from tribute. Direct property taxes were all but unknown under the Republic after 167 B.C. Even in the time of Cicero they were exceptional, and were not infrequently repaid. If enforced military service be regarded as virtually a tax, the distribution of the burden of such taxation was grossly unjust. The public lands rented to the rich were let at a nominal rate. Moreover, the small farmer, who when absent on military service, had no slaves to till the soil, found the sacrifice imposed upon him crushing in its severity. When Rome, like Greece, had sacrificed liberty for security, regular taxes first appeared. Thus a heavy land and poll tax prevailed under the empire. Farmed as it was by the rapacious publicans, it destroyed the very sources of wealth. By its severity whole districts were depopulated and their cultivation was frequently abandoned. The entire process of taxation illustrates how ignorance of finance and economic decay, each in turn a cause of the other, cooperated to disintegrate the empire. In general we find that instead of a normal and periodic activity so characteristic of the state of to-day there prevailed a haphazard policy equally characteristic of the state of classical antiquity. Between the modern and the ancient exercise of governmental function lay all the difference between a steady legitimate business vocation and the ups and downs of a gamester. Instead of

[1] Ihne, History of Rome, Vol. IV., p. 216.

counting upon peace as a normal condition of industry, there was the ever-impending shadow of war. The forces of the antique world were always in unstable equilibrium. A small displacement, instead of tending to minimize itself, tended to overthrow the tottering fabric of the state. Prevision was only a vague preparation for apprehended danger; a probable forecast of income and expenditure on the part of the state was impossible so long as the state was constantly in danger of having to hazard its all for bare existence. Taxation, therefore, as we now use the term, as a self-controlled and periodic contribution exacted from the citizen for the support of the state, was then practically non-existent. It was unknown in the period of self-government in the ancient state, and only its prototype appeared in the final period of Roman imperialism. Forced periodical exactions did prevail, but between these levies and modern taxation there are perhaps as many points of contrast as of resemblance. Finally, public credit was then virtually unknown, inasmuch as the conditions necessary for its emergence had not appeared.

Feudal Finance.—There supervened upon the dissolution of the empire an economic twilight which prevailed for centuries. The universal industrial torpor enforced by the separatist tendencies everywhere prevalent prevented the development of any extensive and enduring financial polity. Agriculture was practically synonymous with industry. Labor was performed by serfs whose condition, while superior to that of the slaves of classic times, was far from enviable. They were personally free, but bound to the soil they tilled. The exchange of products was exceptional, money dealings were rare ; all sorts of mechanical trades, save the rudest handicrafts, were unknown. There prevailed a ' natural

economy' with points of likeness to the family system of Greek industry, but without its political enlightenment and without its culmination in city life. Under such conditions finance was practically the ordering of income and outgo within these numberless agricultural principalities. It was farming and housekeeping on a great scale. The feudal analogue to the financial legislation of the present is to be found in the Capitularies of Charlemagne, the greatest landlord of his day. These were practically nothing but directions to his overseers for the management of his estates. The feudal view of finance was just the opposite of the modern idea of the citizens supporting the state by means of self-willed taxes. In feudal times the lord supported his subjects. He held a claim to their services and their lands. By right and custom the serf owed to his lord so many days of labor per week. The higher vassals owed personal service in time of war. In fact no less than in theory, the lord defended and supported his subject vassals. There was no distinction between the treasury of the prince and the public treasury, and originally the only congener to modern taxes was the customary service rendered to the lord of each petty domain. Later, when commerce began again to expand, the territorial princes established their claim to certain regalian rights of coinage, and of tolls on market, bridge, and highway, but until the era of municipal life there was no approach to the public finance of to-day. With the free cities came the dawn of a better day.

Early Municipal Finance.—Americans easily incline to the belief that city growth menaces a nation's healthy political life, and political salvation is thought to be of the country. In this we generalize perhaps too readily from our own rather dispiriting experience of the last

fifty years. At all events, whatever limited application this idea may have for the present time (perhaps more limited than most of us suspect), we ought not to forget that in earlier times the seed of liberty on the continent of Europe was preserved mainly in the cities when the rural regions were given over to a hopeless despotism. The germ of constitutional liberty was fostered and developed not in the country, but in the town.

The cities of western Europe boasted various historical origins. Not infrequently a temporary market-place in the vicinity of a cathedral or other religious establishment formed the nucleus of the future city. The temporary market became permanent. The authority of the territorial superior, lay or clerical, was not infrequently disputed or thrown off altogether. Walls sprang up around the clustered dwellings. Grants of privileges were accorded by a compliant prince, or purchased from a necessitous suzerain, or wrung by force from an obstinate overlord. The imperial leanings of the cities were not infrequently the outcome of municipal rebellion against the claims of their immediate local sovereigns. Local autonomy, however, was secured in one way or another until a substantial power of self-government became the heritage of the Free Cities. Europe was then throbbing with the pulsations of a new industrial life. The wealth and power of the cities grew apace. The famous Hanseatic League (1250) has been justly termed the precursor of the modern industrial state. It lacked only the element of contiguous territory. It made treaties and equipped navies and waged wars like a sovereign power.

All this was but the reflection of the growing influence of the new Estate,—that of the industrial classes. Naturally enough the domestic and foreign activities of the

cities implied the necessity of adequate revenue. This was forthcoming from the wealthy burgher class, the dominant order in these municipalities. Citizenship had not then been shorn of its eminent attributes. It was not merely a paraphrase for territorial residence. It was a badge of status. It implied ordinarily the headship over a household, an honorable rank in the gild council, a position of influence in civic affairs. 'With a great price' some had purchased this freedom. And these, equally with those who were 'free-born,' were not of the stuff quietly to see their property disposed of, even in the service of the city, without exercising over such expenditure a very considerable degree of control.

Taxes in the towns were at first self-willed grants. They soon became regular instead of occasional. Many of the refinements of later financial systems were anticipated in the ordering of these municipal exchequers. Taxes were levied on polls, on buildings, even on articles of consumption ; and city debts were founded. Conditioned by the age in which it flourished, municipal finance was the forerunner of modern finance, except that the system had found a footing only in isolated centres, instead of permeating the entirety of a territorial state. England's task it was to secure for a nation what the cities had secured for themselves alone.

The Development of Financial Constitutionalism in England. Norman Finance. — The historical significance of English finance dates from the Conquest (1066). Feudalism in England antedated the Norman invasion, but the foundations of a strong central government are traceable to that event. Land was synonymous with wealth and power, and the unification of land tenure effected by the Conqueror had a momentous influence in more than one direction. The king was the

universal landlord. All land vested ultimately in him. Domesday book was at the same time the record of land-titles and the basis of tax-apportionment. Taxes were but little more than the payment of rent to a royal landlord. England thus presented the most thoroughgoing example extant of a rigorous feudal régime. This state of society is graphically described by Bishop Stubbs as "a graduated system of jurisdiction based on land-tenure, in which every lord judged, taxed, and commanded the class next below him, in which abject slavery formed the lowest, and irresponsible tyranny the highest, grade, in which private war, private coinage, private prisons took the place of imperial institutions of government."

The Exchequer System. — The financial administration of the realm was unified under a single royal board or commission—the Exchequer.[1] The members of this body were generally ecclesiastics of the king's household—the chancellor, the treasurer, and others. Indeed the Exchequer was originally not so much a separate tribunal as it was the king's council, the *curia regis*, in fiscal session.[2] The importance of this institution lay in the unification and simplification of English fiscal administration thereby effected. The mould was cast into which the molten metal of constitutionalism was later to be poured.

The early sources of the royal income were manifold.[3] The *ferm* of the county, or land-tax, was exacted by the sheriff, himself a royal publican. The towns paid

[1] The name originated from the chequered cloth which covered the table at which moneys were received. Cf. Stubbs, Cons. Hist., I., p. 407.

[2] Stubbs, Cons. Hist., I., p. 418. Its records exist from the time of Henry II., so that we have the sources of much of England's financial history for a period of six hundred years.

[3] Stubbs, Cons. Hist., I., pp. 410-415.

tallage. The king's court extended its jurisdiction so as to acquire additional fees for the crown. The feudal dues were required from time to time of the king's vassals; and no small part of the royal revenue came from 'reliefs' paid upon the succession to estates, from 'fines,' and from the sale of offices.

The Origin of Popular Control over Taxation.—Like all English constitutional developments the growth of popular control over taxation was exceedingly gradual. In *Scutage* may be found its remote origin. Henry II. in the prosecution of his continental wars found that a feudal army was often an uncertain weapon of aggression. The vassals of the king at the expiry of the wonted period of their annual service insisted upon the right of returning to their homes. In this predicament it is said to have been the famous Thomas Becket who suggested to the king the project of a mercenary army whose pay might be derived from the commutation of the feudal duty of personal service into a money payment. This payment in lieu of service was called *scutage*, or shield-money;[1] and upon this basis of compact followed a series of changes so important in their outcome that Thorold Rogers dubs Becket "the Father of Parliament and scientific finance." Toward the close of the twelfth century additional revenue was needed to raise funds for the Crusades. To apportion the tax properly among the holders of personal estate there were instituted in connection with these extraordinary levies [2] local bodies of assessment. Gradually these boards of assessment were led to claim that their assent was necessary to the validity of this levy. From feudal despot-

[1] Green, Short History of the English People, p. 136.
[2] The Assize of Arms (1181) and the Saladin Tithe (1188). See Dowell, Hist. of Taxation and Taxes, Vol. I., p. 59 *sq.*

ism there had emerged first the vassal's right to make a money composition for the service once due in person, then local boards of assessment which gradually became possessed of the power of refusing their assent to royal impositions. "The whole subject of taxation," to quote Bishop Stubbs[1] again, "illustrates the gradual way in which king and people were realizing the idea of self-government. The application of a representative scheme to the work of assessment, and the recognition that the liability of the payer was based on his own express consent, either to the grant itself or to the amount of his own contribution, mark a state of things in which the concentration of local interests in one general council was all that was needed to secure the taxpayer from arbitrary treatment on the part of either the sovereign or his ministers."

The first popular statement of the essence of constitutional liberty is ordinarily traced to *Magna Charta*[2] (1215). The Crown, it appears, had been wont to amerce its subjects very largely at its discretion, and against this evil practice the barons at Runnymede made their memorable protest. Accordingly, in the twelfth section of the venerable charter the king agrees that "No scutage or aid[3] shall be imposed in our realm without the consent of the general council of our realm, except for ransoming our person, at the knighting of our eldest son, and once at the marriage of our eldest daughter; and on these occasions there shall be paid no more than a reasonable aid." The charter itself was afterwards an-

[1] Stubbs, Cons. Hist., Vol. I., p. 629.

[2] Stubbs, Select Charters, p. 298. An English version will be found in the Appendix of Mr. John Fiske's Civil Government.

[3] Aids were taxes exacted by the lord from his vassal. The three customary feudal aids are here mentioned.

nulled, but this essential principle was caught up and reaffirmed in subsequent royal charters, so that popular control over the exactions of the fisc became the bedrock of the English constitution.

The Extension of Control over Taxation. — Subsequent English history is very largely the reiteration and actualization of the right of self-government. The power of the throne varied with the character of its successive occupants and with the changing external political environment. But the seventeenth century saw the principle of control over taxation firmly entrenched against further successful attack. The action of Charles I. in raising taxes by means of the Ship Writs was not an actual violation of early usage, though the precedents he followed had been made obsolete by circumstances. It was primarily a colossal political blunder. Illegality of procedure on the king's part may have been technically absent; but the strength of Hampden's case (1637) lay not so much in its impregnable legal position as in the tremendous popular feeling which stood behind it. It was the king's inability to read the signs of the times, to understand that his subjects' loyalty to him was second to their attachment to their property, that caused Charles to lose both his crown and his head. The Restoration was but the restoration of a reigning family, not of an outgrown theory of government; and when, as the outcome of the Revolution of 1688, William was called to the throne, 'commercial constitutionalism' had become once for all the unquestioned law of the land. A mercantile people had come to the consciousness of itself. The political power of property was *res judicata*. The conditions were present for the emergence of a national debt, and that significant phenomenon promptly appeared.

The Growth of Constitutionalism. — Self-government has been the heritage of Englishmen abroad as well as at home. The American colonists brought it with them across the Atlantic. Indeed our own struggle for independence was but the reaffirmation of the old principle which the British Crown had been forced long before to acknowledge in its own realm. The war upon the colonies was in reality an attack upon the constitutional freedom of Englishmen in a new habitat. The attitude of the mother country as well as of the colonies with respect to the principle at issue varied most illogically from time to time even after the struggle had begun. But the truth is now clear that the asserted right to tax the colonies, whatever its legal justification, was but a futile attempt to impose upon Englishmen beyond the seas a yoke which neither they nor their fathers had been able to bear. The outcome of the American Revolution therefore was the dissolution of the political unity of English-speaking people; but it was none the less the maintenance of the inviolate sanctity of their common political creed. How deep-seated was the American conviction as to the real nature of the issue involved was seen in the unfailing promptitude with which the control of taxation and expenditure was asserted in the fundamental law of the various commonwealths, no less than in the two great federal charters—the Articles of Confederation and the Constitution. However far we may be from the perfect realization of this control over the public purse—and in the domain of municipal life we are not infrequently mulcted with little shadow of right —the violation of this principle is attempted only under the forms of law or through the disguise of fraud. Formal acquiescence in the rule of popular control over the spending of public moneys is at least the external

obeisance which the most cynical of our modern politicians never fail to pay to the political traditions of their race.

In France the Revolution of 1789 effected the first general acknowledgment of the right of popular control over national income and expenditure. Not infrequently since that time has this right in France been abridged or abrogated, but after its many oscillations between Cæsarism and Anarchy the French nation seems to have returned to the settled point of political equilibrium. Upon the continent of Europe generally it was not until after the various revolutionary movements of 1848 that constitutionalism in its modern sense secured any substantial triumphs. Even now the stability of the liberal order is threatened no less by Absolutism than by Collectivism. Within the present generation Bismarck has been able to defy the mandate of the legislature in Prussia, although he hastened to obtain amnesty for this act when at the height of his military success over Austria.[1] But though menaced on this side and on that, the dominance of the property-owning classes in modern governments is a fact of the first order of importance. Together with the normal and peaceful functioning of modern governments and the vast extension of public credit, it forms one of the pillars of the edifice of modern finance.

[1] Leroy-Beaulieu, Science des Finances, II., p. 15.

PART I.

GOVERNMENT OUTLAY.

CHAPTER I.

THEORIES OF PUBLIC EXPENDITURE.

An individual who determined upon his expenditure before estimating his income would be chargeable with counting his chickens before they were hatched. Yet this seemingly inverted procedure is warranted when the statesman is considering the subject of public finance, and for the following reason: Broadly speaking, the state has the power through legal coercion to force its income up to a point equal to its requisite expenses. The individual does not ordinarily possess this power, and he must consequently regulate his living by his current means. "The private person must . . . regulate his expenditure by his income: the state regulates its income by its expenditure. . . . The individual says, 'I can spend so much': the finance minister says, 'I have so much to raise.'" [1]

The vast majority of all state enterprises cost money, and consequently state expenditure is practically coextensive with state action. Hence it follows that the

[1] Bastable, Public Finance, p, 42. Bastable, however, qualifies this statement materially.

question of the proper field of public expenditure is practically identical with the question, what should the state do and what should it leave alone, or, as it is sometimes more formally put, what is the 'sphere' of the state?

There are various ways of 'determining' this. There is the '*high priori*' method, which starts from supposed axiomatic grounds and proceeds deductively until it throws the meshes of its logical net upon some concrete forms of state activity. There is the '*low posteriori*' process, which hopes by the endless sifting of 'facts' ultimately to establish some generalizations which may serve at least as empirical maxims of statecraft. Lastly, there is the so-called 'historical' solution of the vexed problem. This imports into the question the conception of the gradual evolution of state functions, and not infrequently uses the hackneyed analogy of an 'organism' to illustrate the presumable growth of the body politic. All these modes of procedure doubtless serve a useful end. Their combination may perhaps enable us to construct a valuable theory of the province of government. But whatever the method adopted, the concrete outcome in the case of each successive political philosopher is generally determined by the particular forces which have specially operated upon him. If we disregard chronological sequence, we can readily form a theoretical *catena* which progressively magnifies the sphere of the state from zero to infinity. Bakounine, Spencer, Adam Smith, J. S. Mill, Roscher, Wagner, and Marx form such a series in which each name serves to indicate a new departure in a curved path which ultimately slides off on the tangent of Collectivism. If we avoid the 'falsehood of extremes' we shall find a very general acquiescence in the belief that there are some things which state action is likely to effect with a

balance of advantage in any society. These things are of "such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should erect or maintain."[1] On the other hand, none but the Collectivists will deny the general truth that there are many other things which individual enterprise can best be intrusted to secure. But sharply to draw a line of demarcation between these contiguous provinces, even when concrete circumstances of time and place are taken into consideration,—this is the crux of political speculation.

Practical Solution of the Question.—Happily for us we are not required to solve this theoretical question in advance of enjoying the benefits of an organized polity. The oft-recurring issue with which we must practically grapple is the advisability of concrete extensions of public expenditure. Some vague presumption for or against such a policy may result from the general theory of state functions which we hold. But there is much sense in Professor Ritchie's remark[2] that "when any measure of state action is proposed there is little advantage to be got by asking whether this is the sphere of the state, or whether it is meddling with the sphere of the individual. As if every one could tell beforehand, without any particular experience, what these spheres were. They are what we think they ought to be; and they are not necessarily mutually exclusive. It is much better to ask the utilitarian question, 'Is this particular measure expedient in the case?'" The best working hypothesis, therefore, seems to be this: that in general proper public

[1] Wealth of Nations, Bk. V., Part III.
[2] Principles of State Interference, p. 107.

outlay is such as is normally made by governments at present, and that any proposed extensions of expenditure (retrenchment is almost too good to hope for) must each be judged on its own account. This may seem like practically begging the whole question, but it is not so in reality. State outlay is, on the whole, the result of political experience. That it normally embraces such and such objects, and normally excludes certain other objects, is good ground for the presumption that such state action is in substantial harmony with the political and social environment. "Other things being equal," says Bagehot, "yesterday's institutions are the best for to-day."

This modest solution of the problem seems also to include within itself whatever truth or import may lie in the doctrine of 'historical relativity'—"that the province, and therefore expenditure, of the regulating organs of society will vary at different stages of social progress." [1]

The tests of any proposed extension of expenditure cannot be reduced to rule. Sir James Fitzjames Stephen [2] suggests for any proposed law the three following common-sense criteria: Is the object arrived at good? will the proposed means attain it? will they attain it at too great expense or not? The third principle will sometimes bar out mere cheapness as a controlling consideration. In public economy, no less than in private, niggardliness is often worse than waste. Other conditions remaining the same, however, we may agree with Ricardo [3] in lauding "the golden maxim of M. Say that the very best of all plans of finance is to

[1] Bastable, Public Finance, p. 48.
[2] In Liberty, Equality, Fraternity, p. 137.
[3] Works, p. 145 (McCulloch's edition).

spend little, and the best of all taxes is that which is least in amount." [1]

The Objects of Public Expenditure.—The classification which we adopt of the objects upon which governments spend money will be determined by various considerations. One classification will best represent the historical growth of public outlay, another will best show the division of state expenditure in a particular nation, and still a third will be found most useful when we attempt to collate and compare the expenditures of different governments upon analogous objects. In order to trace the historical growth of state expenditure we may conveniently adopt the fourfold division of outlay upon War, Internal Security, Industry, and what, for want of a better name, has been denominated Social Well-being. In earlier times the citizen rendered per-

[1] Sax and others of the Austrian school allege, if I rightly understand them, that the Austrian theory of value gives us a scientific basis for public expenditure. An individual who will secure the maximum satisfaction from his income must derive from the last (i.e. the least important or esteemed, not chronologically the latest) dollar spent in one line an amount of enjoyment equal to that secured by the last dollar in all other avenues of outlay. The last dollar spent for theatre tickets must give an amount of enjoyment exactly equal to that obtained from the last dollar spent for tobacco. If this is not the case the 'economic man' will shift a part of his outlay from one category to another, say from tobacco to theatre tickets, to maximize his enjoyment. Inasmuch as the citizen's income goes partly for the things he buys himself and partly (in taxes) for what the state buys for him, taxation should be so adjusted that for the marginal dollar that is taken by way of taxation the return in satisfaction should be exactly equal to that obtained by the marginal dollar spent privately. This appears to me to be undeniable, and if by implication the older theorists denied the fact, they were doubtless grieviously at fault. But how to determine where the margin between private and state outgo is to be drawn, or how, admitting that this task is accomplished, to persuade Tom, Dick, and Harry that the respective bounds of state function and private action have been properly meted out—on these points our Austrian friends do not greatly enlighten us.

sonal service in the army, and took part in the adjudication of quarrels between members of his own tribe. These occupations have become specialized at present, and these services are generally rendered by specially deputed public agents who are paid from the public treasury. Still there remain traces of the earlier state of things. Some military services, for instance those of our commonwealth militia, are rendered largely without special remuneration. This was formerly the case with all military service. Various civil offices are still held by non-salaried officials. Not until society had developed economically did the state make any extensive outlay upon industrial interests. But the establishment of weights and measures, the enforcement of commercial contracts, the coining of money, the granting of patents, the protection of shipping interests, the encouragement of certain favored industries, and latterly the supervision of the conditions of labor, have everywhere become public charges. More recently still have modern states begun to expend funds upon a rapidly extending circle of social interests of which education is the most prominent and by far the least questionable. This category serves as a sort of drag-net for all public functions which cannot be classed under the head of Defence, Internal Security, and Industry. It includes the care of the defective, delinquent, and indigent classes, the provision of public luxuries and amusements, and in some states the portentous establishment of industrial pensions.

The Universal Growth of State Expenditure.—That public expenditure is everywhere on the increase is indisputable.[1] A certain increase with the growth of

[1] Bastable, Public Finance, pp. 133-138, for a statistical presentation of the recent increase of expenditure in different states;

numbers was of course to be expected. But the expansion of public outlay seems to be much more rapid than the general growth of population. Though the limits of this treatise will not warrant a statistical presentation of the case, it seems not improbable that the increase in public charges has been relatively greater than the normal increase in the typical national income, even after making all due allowance for the general rise in prices and for the increased expenditure by the state upon projects formerly intrusted to individual enterprise. But more than this is true. "The current of modern sentiment runs as strongly at present in favor of state action as it did fifty years ago against it." Nor is there any difference except one of degree in the practice of English-speaking peoples and other peoples whom we are inclined to regard as especially devoted to the fetich of paternalism. The only difference is that the original impulse with us was popular in its character: in the typical continental state, on the contrary, the movement originated largely with the governments. Nor are Americans a whit behind England in this movement. Mr. Bryce[1] tells us that "the new democracies of America are just as eager for state interference as the democracy of England, and try their experiments with even more light-hearted promptitude"; and he cites overwhelming evidence in proof of his contention.

Our political doctors have frequently analyzed the causes which universally have increased public outlay, and in general they agree in their diagnosis, though they frequently differ in the emphasis they put upon the cooperating factors. Some, like Leroy-Beaulieu[2]

also Roscher, Finanzwissenschaft, § 110; also H. C. Adams, Science of Finance, p. 87 *sq.*

[1] The American Commonwealth, Ch. XCI.

[2] Science des Finances, Vol. II., Ch. VI.

and Cohn,[1] lay the greater part of the guilt upon the head of 'democratic finance,' which they apparently would make the scapegoat of modern politics. Socialism and Nationality—the latter being the growing consciousness of national unity and its immoderate exaltation—are jointly responsible, Prof. H. C. Adams[2] thinks, for the phenomenon in question. "A quickened moral sensitiveness and philanthropic sympathy," together with the discernment of greater benefits which the organized power of government can secure, constitute, in Mr. Bryce's opinion, the main causes of the movement. Others attempt only a more superficial analysis, and ascribe the increase to the growing costliness of the technical apparatus, especially that of armament, which governments must purchase. Some allege that the raised standard of living which necessitates an increase in the salaries of state functionaries is largely responsible for the increase. In the domain of municipal government in the United States a part of the increase must doubtless be attributed to the old-fashioned sin of stealing. The public funds of our cities seem to have a singular tendency to become the spoil of what Adam Smith dubbed 'that crafty and insidious animal' called 'a politician.'

Perhaps the sanest conclusion is that all these causes, in varying proportions, operate in modern states to produce increased public expenditure. It is difficult, however, to make any rigid classification of these forces, inasmuch as they insensibly blend into each other. Nationality, when it becomes a mania, unceasingly de-

[1] Nationaloekonomie, II., § 46.

[2] Public Debts, p. 14. In his recent Science of Finance, p. 94 *sq.*, Professor Adams denies that taxation absorbs an increasing fraction of the public income. For the opposing view see Bastable, Public Finance, p. 137 *sq.*

mands costly experiments in the equipment of armies and navies. It thus lessens the productive energy available for ordinary industry, on the one hand, and creates a class fed at the public crib, on the other. Thus the military establishment first arms Socialism with a valid complaint, and then furnishes it with a vicious model. New Socialism is but old Militarism 'writ large.' If it cannot provoke a foreign war, it sets itself promptly to the work of internal spoliation; if temporarily precluded from purchasing battle-ships, it consoles itself with subsidizing beet-culture and other equally important interests. Both tendencies naturally coincide in their advocacy of extended grants of pensions. The normal trend of modern economic life, moreover, does operate undoubtedly to raise the standard of living, and thus necessitates higher salaries for public officials. City growth also involves inevitably increased expenses for police, for the construction and maintenance of streets, for the supply of water, and for the thousand and one necessities of urban life. And not infrequently a sensibly relaxed control over public officials increases the cost of government. It would be markedly hasty to pronounce dangerous all increased outlay. At the same time it is proverbially easy to spend other people's money, and legislators no less than electorates need frequently to be reminded of the fact.

CHAPTER II.

EXPENDITURE IN THE UNITED STATES.

Federal, State, and Local Expenditure. — In no modern state does the expenditure of the central or national government comprise more than a part, though frequently a great part, of the total public outlay. The various local governments are charged with making supplementary expenditures which are devoted to interests mainly of a local nature. The assignment of certain functions to the national government and to the subordinate governments respectively, is determined in each state by its own constitution. We find, therefore, great variety of detail in the classes of charges which are defrayed in various states, now by the central and now by the local governments. Perhaps no general law can be laid down to explain the apportionment of expenses to be borne by each, except the rather vague statement that strong centralizing tendencies and the absence of vigorous local self-government tend to throw the greater part of this financial business upon the national government.[1]

Under our Constitution certain powers are delegated to the federal government, and certain other powers are

[1] Bastable, Public Finance, p. 123, *note*, where it is estimated that the ratio of local expenditure to central expenditure in France, Italy, Great Britain, and the United States is 22, 25, 43, and 61 per cent. respectively.

reserved to the commonwealths and to such local units of administration as the commonwealths may create. Thus the line between federal and non-federal expenditure is drawn by our organic law. Two jurisdictions, the one federal and the other that of the commonwealth, cover the same territory. Thus it comes about that both the national government and each commonwealth for itself maintains a civil establishment embracing executive, legislative, and judicial departments. Beyond this duplicated civil establishment a broad line of demarcation between federal and non-federal expenditure may readily be drawn. The expenditures of the federal government are made mainly for national purposes. Here are included the expenses of the federal military and naval establishments; the former covering the improvement of harbors and rivers, the latter the cost of constructing new vessels of war. Besides these charges the interest on the national debt, the payment of federal pensions, the maintenance of the postal service, and certain other miscellaneous objects, among them the Indians, summarize the remaining items resting upon the federal budget.

Non-federal expenditure, on the other hand, embraces the appropriations made by the commonwealths and the various local governmental units. These local governments include the counties, municipalities, townships, and school districts. This non-federal expenditure goes for purposes of state or local importance, such as education, the interest on state and local indebtedness, the support of charitable, penal, and reformatory institutions, police, lighting, the construction of such public works as streets, sewers, bridges, and waterworks, the purchase of parks, and the like.

The total expenditure by governments in the United

States is over one billion dollars per annum. The per capita sum expended in 1890, excluding postal expenditures, which were largely reimbursed by postal receipts, was $13.65.[1] It is a matter of no little interest to notice how the various governments, federal, state, and local, participate in the expenditure of this enormous aggregate.

The Eleventh Census [2] contains the following table of expenditures made in the United States in 1890:

National government, including postal service	$352,218,614
States, territories, and D.C., except for public schools	77,105,911
Counties, except for public schools, partly estimated	114,575,401
Municipalities, except public schools, partly estimated	232,988,592
Public schools	139,065,537
Total	$915,954,055

A minute's scrutiny of these figures will show that about forty per cent. of our gross public expenditure is made by the federal government. This is a relatively smaller proportion of the total expenditure than we find made by the central government in Great Britain or in the continental states. It serves, however, to emphasize the dominant rôle which the federal government plays in our constitutional economy. Compared with the annual outlay of the national government, the expenditure of any single state or municipality shrivels into insignificance. The next fact to be noticed is the comparatively small financial importance attaching to our common-

[1] See U. S. Census of 1890, volume on Taxation and Valuation. These figures, prepared by Mr. J. K. Upton, special agent of the Eleventh Census, are particularly useful.

[2] Volume on Taxation and Valuation. The separate itemization of expenditures upon public schools was necessitated in part by the fact that certain commonwealths raise school funds by a state tax. The funds so raised are applied to the maintenance of schools in the various localities within the state.

wealth governments. Less than one tenth of the total expenditure goes to defray the cost of the commonwealth governments. The truth is that our states have been shorn of most of their financial prestige. They still retain their constitutional prerogatives. They are still the fountain of authority from which the financial powers exercised by local governments are legally derived. But they are themselves of secondary moment as compared with the federal government on the one hand or with the aggregate of local governments on the other. In the magnitude of their expenditure several of the commonwealth governments are overshadowed by the great municipalities within their borders.

The third fact that the statistical table indicates is the growing prominence of local and especially of municipal finance. From an historical standpoint so marked a contrast between federal and state finance is very noteworthy. The net ordinary expenditures of the federal government during the first decade of its existence averaged something over four millions of dollars annually. The aggregate commonwealth expenditure must have been nearly as much. In 1842 the net ordinary expenditure of the federal government was $24,361,336. In that same year the aggregate commonwealth indebtedness was over two hundred millions, upon which the annual interest must have been equal to almost half of the total federal expenditure per annum.

It is true that 1842 marked the culmination of the internal-improvement mania on the part of the commonwealths, and so the figures used in the comparison of state and federal expenditure for that year may be regarded as abnormal. Still the wholesale embarkation of the commonwealth governments upon enterprises of that nature was significant, and heightens the contrast be-

tween their daring initiative in earlier times and their severely curtailed powers in that direction to-day. The growth in the relative power of the federal government and the rapid increase in our urban population have become commonplaces long since. But the past and present financial activity of the federal, the state, and the local governments, as shown in the recent Census reports, give another striking confirmation of these political and social tendencies.

Analysis of Federal Expenditure.—The tabulated summary employed in official reports of federal expenditures is divided into seven sections which cover respectively the cost of the civil establishment, the military establishment, the naval establishment, the Indian service, pensions, the interest on the public debt, and the postal service.[1] Most of the items are self-explanatory, and but a word need be said in elucidation of the others. The civil establishment includes the salaries paid to the officers in the executive, legislative, and judicial departments of the civil service, the cost of foreign intercourse, public buildings, the collection of the revenues, the expenses of the District of Columbia, the inevitable deficit in the postal revenues, and a host of miscellaneous expenses. The military establishment includes not only the current expenses of the maintenance of the army, but (as already mentioned) the improvement of rivers and harbors, the erection of forts and coast defences.

Similarly the naval establishment comprehends the construction of new vessels as well as the current expenses of the navy. The postal service is not entirely self-supporting. Such revenue as is received by the

[1] The Annual Reports of the Secretary of the Treasury and the Treasurer of the United States give detailed accounts of federal receipts and expenditures.

post-office department goes to defray the cost of the postal service; the remaining deficit is made good by appropriations which are charged to the civil establishment.

Carefully to analyze the various appropriations of the federal government would require an amount of space which the limits of this work will not permit. There are, however, several salient features of which some notice must be taken. Briefly put, these questions relate to the salaries paid to the higher officers of the government, the decreased interest charge, the increased cost of the navy and of war pensions, and the likelihood of increased federal expenditure generally.

A paid legislature such as our Congress is necessarily an expensive body.[1] The payment of legislators is based on the democratic idea of keeping open the door of political preferment to men of ability who are not rich. The number of salaried legislators makes the aggregate expense of our national legislative mill much greater than where legislators serve gratuitously, as in England. It is also characteristic of democracies, as Roscher[2] observes, that while the average pay of their public functionaries is high, there is less difference in the pay of the higher and lower ranks than in monarchic or aristocratic countries. The effect, therefore, is twofold: not only are the legislatures in democratic states a heavy charge upon the revenue, but the comparatively moderate pay of the legislators serves to attract rather mediocre ability. The "cheap coin of honor" may serve in part to eke out the scantiness and the uncertainty of political preferment, but at the same time the temptation to corruption lurks in the underpayment of

[1] In 1896 the cost of Congress was $7,736,610.
[2] Finanzwissenschaft, p. 503.

high officials. It is to-day tolerably certain that the highest officers under the federal government are badly underpaid. Especially is this true of the Cabinet secretaries, the federal judges, and the members of Congress. Persistence in this policy of niggardly remuneration out of deference to supposed democratic principles must tend increasingly to allure into politics little men for whom the present remuneration is adequate, or wealthy men for whom any cash remuneration is a matter of comparative indifference. The need of increased pay, moreover, is more urgent in the judicial department than in the legislative and executive departments, where the few great political prizes will always attract a large number of aspirants into the arena of politics.

The recent marked increase in naval expenditure dates from 1889. From 1886 down through 1894 there was a steady increase in the outlay upon this head, the charges advancing from $13,907,887 to $31,701,293 per annum. In 1897 they mounted to $34,561,546, and since the recent war they have tended upwards, the estimates for 1900 being over $47,000,000. The view one takes of this form of government expenditure will be determined by his view of the probable use of the navy in future. That our ships and armament were antiquated and needed replacement can hardly be denied. But where the process of increasing the navy will stop is another question. If we are to pursue the quiet policy of doing our share of policing the world's waters, of enforcing our own revenue laws, of having an armament sufficient for defensive operations and large enough to serve as a nucleus of an enlarged navy in case of need, we ought to follow a conservative policy in this regard. If we are to assume an aggressive attitude in our foreign policy, to engage readily in international complications, and

generally to play the rôle of *enfant terrible* in the family of nations, swollen naval outlay is the proper means to attain such an end.

The most marked changes in federal expenditure during the last thirty years have been the decrease in the interest paid on the national debt and the portentous increase in the payment of war pensions. The other items of expenditure have shown only a slow variation. The diminution in the interest charge has been due to the rapid reduction of the debt's principal. The surpluses over current expenditures have been applied in great part to the extinction of the government's bonded obligations. Thus in 1867 the payment on interest account was $143,781,591, or over seventy per cent. of the net ordinary expenditures. In 1893 there was but $27,264,392 paid in interest, an amount less than eight per cent. of the net ordinary expenditures for the same year. During the year 1897–8 interest charges absorbed $37,585,056. The policy of debt payment will be discussed in another place. Whatever be said of our federal revenue system as a whole, if it yielded surpluses above current expenditures, there could be no wiser policy pursued than applying these surpluses to expunge the national debt.

Federal pension expenditure is a far less gratifying branch of national finance. As the interest charge has diminished, war pensions have steadily increased, so that if the national debt as well as the disabilities and loss of life incurred during the war be regarded as the joint results of that struggle, the annual charge is to-day as heavy as it has ever been.[1] From the close of the civil

[1] In 1867 the aggregate expenditure for pensions and interest was less than 164 millions of dollars; in 1898 the aggregate was over 147 millions. These figures are based on the reports of

war until 1880 pensions never absorbed more than thirty-five millions in a single year. In 1880 pension expenditure increased by over twenty millions, and reached the sum of eighty-seven millions in 1889. Congress still pursued its liberal policy with the following results:

1890	106	millions	expended.
1891	124	"	"
1892	134	"	"
1893	159	"	"
1894	141	"	"
1895	141	"	"
1896	139	"	"
1897	141	"	"
1898	147	"	"

The increase of pensioners on the rolls was as follows:

1889	489,725
1890	537,944
1891	676,160
1892	876,068
1893	966,012
1894	969,544
1895	970,524
1896	970,678
1897	976,014
1898	993,714

Whatever may be thought of our present pension policy there is one thing undeniable, that if our pension policy to-day is nothing more than adequate and just,

the Secretary of the Treasury. It must be borne in mind that the latter reports are made on a gold basis, whereas prior to 1879 paper currency was below the gold par.

our pension policy for the first twenty years after the civil war was niggardly in the extreme. Indeed, if one had no evidence other than the pension rolls, one might readily draw the conclusion that there had been since 1860 two wars of about equal magnitude, the latter taking place some time in the early nineties. It is no hazardous assertion that the consensus of conservative opinion holds our present pension expenditure to be exorbitantly extravagant and excessive. The discouraging feature about it all is the cowardly subservience of both political parties to the clamant pretensions of the advocates of extended grants. Nor is it less deplorable that for this evil as for so many others time seems to be the only remedy. To repulse invaders from the public crib is indeed difficult, but to expel them when once they have battened thereat is all but impossible.

Upon the general question as to how rapidly federal expenditure in the aggregate is likely to increase, little or nothing of value can be said. Some increase is to be expected with the growth of population. More is to be feared from the adoption of some of the many schemes of 'improvements' so called which are being broached in various quarters. Besides the normal expenditure of government there is always the danger of war, which so frequently throws financial calculations to the winds. Economy has never been a striking virtue of legislators, and if the future reproduces the past there is little to warrant any golden expectations in this department of finance.

Analysis of State and Local Expenditure.—Reference has already been made to the different objects upon which federal and non-federal expenditures are made. There still remains the task of separating the latter into commonwealth expenditure proper and local expendi-

ture. Here again the subsidiary character of what is strictly state outlay becomes manifest. Less than fifteen per cent. of the non-federal expenditure in 1890 went to defray the expenses of the comonwealth governments. In one way, perhaps, this statement unfairly emphasizes their financial insignificance. More than fifteen per cent. of the total amount of the non-federal revenue received is taken in by the commonwealths, but they in turn hand over a great part of these receipts to the local units of government. Thus in 1890 the commonwealth receipts amounted to $116,157,640, while the expenditures aggregated only $77,105,911. The difference between these sums was for the most part turned over to the local governments, for which the commonwealth acts as a sort of tax-collector.

Strictly to separate the objects upon which the commonwealths and the local governments respectively spend their money is impossible. Not infrequently both contribute to the same object, as, for example, to education; and not infrequently the line of division between state and local expenditure in one state is not identical with the line drawn in another. Outside of this common territory, however, the commonwealths defray the expenses of their own civil establishment and the state debt charge, and very generally bear the brunt of such public burdens as the care of the defective classes, the deaf-mutes, the blind, and the insane; the cost of reformatories, the state militia, and the expenses of various state boards or commissions, such as railroad commissions, insurance commissions, tax commissions, and the like.

The cost of all other objects, mainly local, is met by the various local governments. Here are included such charges as education, police, the fire department, construction of streets, bridges, sewers, lighting, water-sup-

ply, and sanitation. A list taken from the last U. S. Census, giving state and local expenses for 1890, runs as follows:

STATE AND LOCAL EXPENDITURE, 1890.

Education	$145,583,115
Roads, bridges, and sewers	72,262,023
Interest	46,649,139
Charity	39,958,816
Other salaries and commissions	37,552,655
New buildings	34,513,020
Police	23,934,376
Judicial, including county courts	18,721,383
Buildings and maintenance	17,950,177
Fire departments	16,423,820
Penal and reformatory	12,381,425
Lighting	11,363,780
Water-works	5,517,193
Executive	5,476,940
Legislative	3,987,774
Health Departments	3,280,294
Parks	2,962,697
Military	2,692,211
Miscellaneous	68,041,796
	$569,252,634

Education easily leads all other charges in point of magnitude, amounting to about one fourth of the total non-federal expenditure. The increase in this department has been very rapid, the per capita outlay upon pupils enrolled increasing from $7.99 to $11.03 in the decade from 1880 to 1890. Education is much more liberally supported in the North and West than in the southern

states, the per capita expenditure in the South being less than half the same expenditure elsewhere in the United States. The various sections of the country differ also in regard to higher education. The colleges and universities of the East are largely upon private or denominational foundations, whereas in the West, and also to a certain degree in the South, the state generally subsidizes higher education. One of the vexatious questions attaching to the public support of education is the demand made by certain religious denominations for a division of the school funds. The number of denominations makes religious instruction in the public schools practically impossible. Non-religious education is regarded by many as substantially irreligious education. Consequently their only escape is to send their children to private or denominational schools. This, they claim, subjects them to what is practically double taxation for the education of their children. Hence they demand a *pro rata* division of school funds. Their main contention may or may not be true. But even from a purely secular point of view it seems deplorable that the public schools give no instruction in religion. A *via media* has been suggested which would maintain the integrity of the present public school system, but would provide for adequate religious instruction for all denominations. The clergy, it is proposed, shall take for a certain time each week the place of the regular teaching staff and give instruction in religion; this would allow each denomination to have its own religious instruction in the schools. Moreover, it is not unlikely that such instruction would be given without additional expense to the state, each denomination defraying the expenses of its own clerical teachers. Special provision might be made for such as do not desire their children to receive any re-

ligious teaching whatever. Some such compromise is certainly preferable to a double school establishment, parochial and secular, with its attendant difficulties.

Next to education, the construction of various public works and improvements absorbs the greatest share of local revenues. Here are included roads, streets, bridges, sewers, and the like. The policy of special assessments seems to be a rough approximation to justice in distributing the charges for local improvements between such property owners as are specially benefited thereby and the general public.[1]

Next in order of size, comes the payment of interest upon the indebtedness of the states and local governments. The principal of this indebtedness amounted in 1890 to $1,135,210,442.[2] Ten years before it stood at $1,123,278,647. The increase in the last census decade therefore has been comparatively slight, and the per capita indebtedness has actually decreased from $22.40 to $18.13. The outlook on this account is accordingly reassuring. If the productive assets of the state and local governments be taken into consideration, the amount of their indebtedness becomes still less serious.[3] The only remaining item of expenditure of which we need take special note is that of Charity. As has been already intimated, this charge for the support of the insane and physically defective classes falls mainly on the state governments. Poverty is relieved mainly by the local governments. These objects are liberally provided for.

[1] Rosewater, Special Assessments, pp. 137-145.

[2] Its distribution is as follows: (U. S. Census, 1890, Public Debt.)

State debt	$228,997,389
County debt	145,048,045
Municipal debt	724,463,060
School district debt	36,701,948

[3] Ely, Taxation in American States and Cities, p. 514, *note*.

Mr. Bryce[1] has cited "the influence of a quickened moral sensitiveness and philanthropic sympathy" as one of the main causes which have operated to increase expenditure generally. And certainly it is operative in this particular province of public spending. "The sight of preventable evil," he tells us, "is painful and felt as a reproach. He who preaches patience and reliance upon natural progress is thought callous. The sense of sin may, as theologians tell us, be declining; but the dislike to degrading and brutalizing vice is increasing: there is a warmer recognition of the responsibility of each man for his neighbor, and a more earnest zeal in works of moral reform."

Upon the general subject of the future of municipal and state expenditure more can be said than upon the same question when raised in connection with federal finance. The reason is twofold. The functions of state and local governments are less likely than those of the federal government to be affected by the perturbations of international politics. Secondly, the trend of constitutional law is certain as regards spending by legislatures and municipalities. Restrictions upon the use of the credit of the commonwealth or the local governments, as well as on their spending powers, are found in most state constitutions. Such provisions are almost inevitably inserted when a new constitution is framed. "One feels, in reading these multiform provisions, as if the legislature was a rabbit seeking to issue from its burrow to ravage the crops wherever it could, and the people of the state were obliged to close every exit because they could not otherwise restrain its inveterate propensity to mischief."[2] The small aggregate increase

[1] Bryce, American Commonwealth, Chapter XCI.
[2] *Ibid.*, Ch. XLIII. See also Ely, Taxation in American

in non-federal indebtedness between 1880 and 1890 is significant. Indeed there seems some reason for hoping that extravagance in state and local spending is almost under control, and that whatever increase takes place in future will be warranted largely by the growth of population and by the necessity of meeting such new requirements as may arise.

Comparison of American and Foreign Expenditure.— It remains to compare the aggregates of expenditure in America and in foreign countries, and also their respective allotments of money for similar public purposes. The determination of the money sums paid out by various states is a comparatively easy matter, but the inferences drawn from such statistics are very liable to be misleading. It is certain, for example, that the aggregate expenditure in the United States, federal, state, and local, exceeds the aggregate spent by any other modern state. But even this tells us very little. To afford any approximate basis of comparison we must determine first the per capita expenditure made in various states, and then translate this per capita money sum into the commodities it will purchase in various states. This per capita amount in standard commodities must then be compared with the per capita income expressed in the same commodities. Even then certain corrections must be made. Allowance for compulsory military service is a correction of the first order of importance. Moreover, the relative functions performed by various states must be taken under consideration in order properly to weight the balances of comparison. A state that purchases and operates railroads will make a large nominal expenditure

States and Cities, pp. 508, 509. Some state constitutions forbid municipal debts to exceed a certain fixed percentage of the property valuation of the cities within the state.

for interest on the purchase-money. But the citizen of that state will perhaps have the benefit of lower transportation rates, and thus the state's expenditures will really cover what in other countries would be a part of the private citizen's expenses of transportation. So serious are all these difficulties that a statistical presentation of the relative weight of expenditure in various states is liable to be vague or deceptive. Perhaps the most we can venture to assert is that expenditure is less heavy in newly developing economic communities, perhaps because of the relative ease of obtaining a livelihood than because of special economy or prudence in laying out the public funds.

The question of the distribution of expenditure upon different objects in various states is more readily solved. Here the United States presents a contrast to most European states in spending strikingly less for defence and for the interest upon its public indebtedness, and markedly more upon education, than they. It is estimated[1] that the expenditure upon public defence (mainly, of course, in support of the war establishment) absorbed in 1888–9 of the total public outlay in Great Britain, in France, and in Prussia 12.40, 19.27, and 17.50 per cent. respectively. In the United States, if we except the expenditure on rivers and harbors (which is put ordinarily among the expenses of the War Department), the total cost of defence, including the building of new ships of war, took but little over six per cent. of the total national, state, and local expenditure in 1890.

For fear that such a showing may seem too favorable, we ought to remember, first, that our geographical position secures us from foreign aggression; secondly, that

[1] Conrad, Handwörterbuch der Staatswissenschaften, article Finanzen, Vol. III., p. 458. The estimate is Kaufmann's.

the cost per man in the federal army and navy is very large as compared with analogous expenditure abroad; thirdly, that the tendency of late has been rapidly to increase the yearly expenditure upon the navy; and lastly, that the enormous pension expenditure is quasi-defensive outlay. If war pensions were classed among our expenses for defence, the absolute and relative amount in money spent on that score would be greater here than in any other modern state.

The total expenditure in the United States to defray the interest upon public debt is in marked contrast to what we find abroad. In 1890 the interest charge absorbed little over nine per cent. of the total. In 1888–9 in France the interest charge absorbed 23.74 per cent. and in England 16.94 per cent. of the aggregate expenditure. The comparison would be more notably in our favor if we compared the expenditures merely of the central governments in these three states.

Most gratifying, finally, is the comparison of the expenditure which our governments and foreign governments make upon education. In 1890 about sixteen per cent. of the aggregate outlay in the United States went for educational purposes. In Great Britain less than six per cent., in France less than ten per cent., in Prussia but little over ten per cent. was expended upon the same object in 1888–89.[1] Moreover, it is noticeable that in France and Germany a great portion of the sum spent was devoted to higher education, whereas the great bulk

[1] In Prussia in 1882-3 more was spent for higher education than for popular education, the cost of the latter being defrayed in part by the fee system. The French expenditure on higher education exceeded that on popular education in 1883. Roscher, Finanzwissenschaft, p. 552. The French have recently begun to follow the American and English procedure in regard to the apportionment of funds devoted to educational purposes. Schönberg, Handbuch der Polit. Oek., p. 52.

of American and English expenditure goes for primary education. This last comparison brings out what is undoubtedly the most promising feature in our public expenditure.

EXPENDITURES OF THE NATIONAL, STATE, AND LOCAL GOVERNMENTS IN THE UNITED STATES, 1890.

(U. S. Census of 1890.)

Pensions and other charities	$146,895,671
Educational purposes and public schools	145,583,115
Interest on debt	82,748,423
Roads, bridges, sewers, and ditches	72,262,023
Postal service	66,259,547
Public buildings and sites[1]	38,890,970
Salaries, fees, and commissions	37,552,655
Military purposes	35,537,611
Police	23,934,376
Judiciary	23,071,075
Public buildings and maintenance[2]	17,950,177
Executive department	16,770,801
Fire	16,423,820
Naval establishment, except for new ships	15,174,403
Penal and reformatory institutions	12,381,425
Improving rivers and harbors	11,737,438
Lighting	11,363,780
Congress and legislative	10,485,826
Constructing new war vessels	6,831,803
Indians	6,708,047
Health departments	3,280,294
Public parks and places	2,962,697
Foreign intercourse	1,648,277
Miscellaneous	109,499,801
Total	$915,954,055

[1] Construction and purchase separately reported.
[2] Construction and purchase not separately reported.

PART II.

GOVERNMENT INCOME.

CHAPTER I.

TAXATION: ITS ESSENTIAL NATURE.

Different Sources of State Income.—To meet its expenses the government must secure an income. This income it obtains mainly in two ways—by taxation and by managing certain business enterprises.[1] Of the public revenue at the present time by far the greater part comes from taxes. Certain undertakings, however, the state carries on, and from them derives an additional income. Thus the delivery of the mails and the performance of certain other services, such as supplying water in cities, are examples of the industrial pursuits of the state. Not infrequently, too, the operation of the railroad system or the telegraph system is in the hands of the state. Between these two generic kinds of income there is one marked difference. Taxes are

[1] For the sake of brevity it is here convenient to regard the productive property of the state as an enterprise whose yield is due to state management and supervision. Public income arising from fines is small and may be neglected. For a thoroughgoing but somewhat complex subdivision of public income see Seligman, Essays in Taxation, p. 303; H. C. Adams, Science of Finance, pp. 219-228.

compulsorily exacted, generally without the rendition of any specific equivalent to the taxpayer. Not so with the other part of the government's income. This is obtained by the state's performance of specific services or its sale of specific commodities for money. Inasmuch as this is a very common way for individuals to obtain their living, it has been proposed to call public income analogously derived the quasi-economic income of the state, in contrast to the state's revenue derived from taxation. Another name for this quasi-economic income is contractual income, so called because such income involves ordinarily a contract between the government and the individuals who patronize public industrial enterprises. It must not be imagined because the amount now obtained by taxation far exceeds the quasi-economic income of the government that the latter always has been of secondary importance. Indeed in earlier times under the feudal régime [1] taxes were of minor importance, and the greater part of the public income was quasi-economic in its origin. Moreover, it seems not at all impossible that the quasi-economic income of governments may take on increasing importance in the future. Certain continental states derive considerable revenue from their public domain and from public industries. European cities frequently defray a substantial part of their expenses by means of their quasi-economic receipts. Thus Berlin from its gas works alone obtains net profit enough to cover about six per cent. of the city's annual expenses.[2] Paris derives over one fifth of its revenue from public services and from productive property owned by the city. Some think that "we can discern a tendency

[1] See page 16.

[2] Cf. Shaw, Municipal Government in Continental Europe, pp. 471, 472.

in taxes to occupy a place of relatively decreasing importance even in American budgets," but this, while possible in municipal budgets, is very unlikely as regards the federal government or the state governments.[1] The consideration of these quasi-economic receipts in detail will follow the study of taxation.

Nature of Taxes.—The word taxation covers the processes both of collecting and paying taxes, and a tax is a legal exaction made by the government upon its subjects for public ends. This definition includes everything essential to a tax—its coercive character, its bearers or supporters, and its specific purpose.[2] Mr. John Fiske's definition will serve as a terse and graphic, though somewhat elliptical, description: "Taxes are portions of private property taken for public purposes."[3]

It is absolutely essential to grasp the idea clearly that a tax is always a burden upon some particular person or persons. There never was a tax which did not saddle some one with a load, nor, from the nature of things, can there ever be such a tax. It is the more necessary to insist upon this almost self-evident truth because certain definitions of taxes and much reasoning about taxation be-

[1] Cf. Ely, Taxation in American States and Cities, p. 49 *sq.*, for the former view; in opposition, Bastable, Public Finance, p. 244; Plehn, Introduction to Public Finance, p. 276. In the English financial year 1893-4, of all receipts only 6 per cent. came from quasi-economic sources. In local finance the proportion was about 5 to 1 in favor of taxes. Even in Prussia, where the quasi-economic receipts yield 64 per cent. of the gross revenue, they yield only 20 per cent. of the net revenue.

[2] The only exception that is likely to be taken to this definition will come from those who believe with the State Socialists, or with the Collectivists, that taxation has a double end and includes both the support of the state and the redistribution (in whole or part) of wealth. Cf. Wagner, Finanzwissenschaft, II., p. 210 *sq.*

[3] Civil Government, p. 3 *sq.*

fog this indisputable fact. So eminent a jurist as Judge Cooley[1] is misleading in this respect when he defines taxes as a "contribution of persons or property . . . for the support of government and for all public needs." Property is always the property of some person or persons, and consequently when private property is taken by taxation the former owner suffers the loss. Putting this into the technical language of finance, we may say the "subject," or the bearer of taxes, is always a person. On the other hand, the bases on which taxes are levied are numerous. In this sense it is true that persons or property may contribute to the support of the state; that is, taxes may be levied upon individuals as such, or upon property as such, without regard to its ownership. The basis, whatever it be, on which taxes are levied is technically called the "object" of taxation.[2] But it must always be remembered that when property or capital or income is said to pay taxes, the immediate reference is to the basis upon which the tax is levied, rather than to the bearer of the weight of taxation.

To understand the true inwardness of taxation we must regard taxes from the standpoint of the taxpayer both as an isolated individual and as a member of society. Viewed from the first point, taxation is the abstraction of a certain amount of private property from the taxpayer's control. Taxes are thus regarded by him as a cost or expense, an evil "in the sense that every sacrifice is such." But this is only one side of the case. The tax-

[1] The Law of Taxation, p. 4.

[2] It is to be noticed that "object" as here used has no reference to the end or purpose towards which taxation is directed. When the "object" of taxation is rubricised under an economic concept, we call the object the "source" of taxation; e.g. capital is a "source" of taxation.

payer's loss is not an absolute loss, such as one incurred by bad debts, or by fire without insurance. As a return for the property surrendered in taxes the taxpayer as a citizen gets a share in the benefits of government. Considered from both standpoints, taxation may be regarded as an enforced surrender of private property by the taxpayer for an undivided interest in government property and services. The true inwardness of normal taxation then is this,—not that the taxpayer gets nothing for what he pays out in taxes, but that what he gets and what he pays for what he gets, are immediately determined, not by himself, but by a political superior. The social standpoint here practically coincides with the individual standpoint. When society surrenders a part of its means by taxation it is using its resources in a particular way which the government prescribes.

Every cost, whether incurred by the individual on his own account, or imposed by society at large through taxation, aims at the attainment of some supposedly desirable end. The end towards which taxation looks is the maintenance of the government. The state's activities are normally presumed to be beneficent. Viewed in this light taxes are essentially a collective payment for public services. This conception of taxation carries with it the doctrine of the proper limits of taxation. Like any other expenditure, public or private, taxation should stop where additional public outlay does not secure corresponding advantages, or where leaving property in the hands of the taxpayer would secure greater advantages to society at large than collecting such property by taxation and disposing of it for public purposes. Theoretically, therefore, taxes may be too low as well as too high. Experience and observation,

however, show the danger of too low taxes to be largely imaginary.

Much ingenuity has been wasted in trying to prove that it is always advantageous that taxes be paid out of income rather than out of capital. This theory, in the first place, falsely suggests that income and capital are distinct and mutually exclusive things, whereas they are merely distinct modes of measuring the same thing—to wit, wealth. Not only are the implications of this theory misleading, but its assertions are false. When taxpayers actually pay taxes out of their incomes they curtail their current private expenditures; when they actually pay taxes out of their capital they simply lessen the amount of property they had previously amassed. There is no particular reason for thinking that the former course is universally to be preferred. When it comes to a concrete choice between curtailing current expenditure and trenching upon "a sacred mass of matter," it may be wise to do the latter, just as, under the stress of circumstances, it may be necessary to do both. Legislation, moreover, must obviously be impotent to prescribe which course the individual taxpayer shall pursue. This ideal rule of taxation, therefore, proves upon examination to be not always desirable if possible, and not always possible if desirable.

Much fruitless controversy also has waged around the proposition that net income is the only possible, or at least the only permanent, source of taxation. If this statement means that taxes which not only lessen current expenditure, but yearly trench upon and diminish private capital, will ultimately exhaust this capital and so cannot last forever, it is obviously true. But if the statement mean, what it is frequently interpreted to mean, that taxes are a junior lien on public income, and cannot

be paid until the ordinary commercial expenses of production are first met, it is demonstrably false. This latter position has been arrived at from considerations such as these: no individual citizen, it is argued, can pay taxes unless he have some income over a bare subsistence: but what is true of one citizen is true of all citizens: hence the only source of taxation in general is the sum of net incomes, or, what comes to the same thing practically,[1] the only source of taxation is the net national income.

The fallacy in this argument consists in the assumption that there must be something in society corresponding to what exists in each unit of society. Similarly we might argue: scarcity of corn is good for the farmer because it brings him good prices: but practically everybody produces something: hence a scarcity of every product would be good for society generally. Tacitus speaks of those who create a wilderness and call it peace; this plan would create a famine and call it prosperity. Evidently there are certain functions performed by government, such as the protection of life and property, which precondition all industrial effort. Taxes which secure these services must be regarded as among the necessary and fundamental costs of society's industrial efforts. They must be paid even if the net national income for the time being is turned into a negative quantity, and even though the national capital be thereby impaired.

Fallacies concerning Taxation. — If the nature of taxation has been properly apprehended as a devotion of a part of society's aggregate wealth to public ends,

[1] Cf. Roscher, System der Finanzwissenschaft, 35, p. 158. "Wir müssen praktisch als Quelle der Steuern das Reineinkommen der Pflichtigen bezeichnen."

and justifiable only so far as the social benefits of government expenditure exceed those of private use, the fallacies in which taxation is sometimes involved will be readily perceived. Most of these fallacies result from ignorance of fundamental economic principles. An especially fertile source of error is the delusion that the state somehow has creative power in the domain of production. This is the so-called "magic-fund delusion." It finds expression, for example, in the assertion that though taxation in general be an evil or a cost, yet it is an advantage to those who sell their goods to the state or who receive their salaries from the state. This in one sense is true enough, but the implication is that these goods sold and services rendered to the state are over and above what would be economically in demand were the state's demand for goods and services to be reduced. The positive form of this delusion is the argument for the public employment of the unemployed, not as an occasional act of necessary charity, but on the ground that such employment "makes work."

In confutation of this error, it may be said that those who sell goods or who render services to the government are not, in the long run and apart from temporary conditions, specially benefited by being paid out of the proceeds of taxation, unless indeed they thus get for their goods or services more than they could otherwise get for them in the open market. Such persons derive their incomes in substantially the same way as other persons do, by producing useful commodities or rendering useful services for which they happen to be paid out of taxes instead of being directly paid by their fellows. Should the government take less by way of taxation and spend less for goods or services, the greater amount left in the hands of the community would constitute a fund out of which

ultimately these former recipients of taxes would be paid.

Those who hold the idea, therefore, that they who live on the proceeds of taxation somehow transform the payment of taxes from a total to a partial loss, misconceive not only the true nature of taxation, which is a sacrifice incurred to secure a desirable end, and which is none the less a sacrifice because the end involves the purchase of particular goods or services, but they also labor under the delusion that public expenditure actually creates for goods and services a demand which otherwise would never exist. This is really "the great political superstition"—that the state is not subject to the general law, *ex nihilo nihil fit*. Similarly it must be clear that if more property than usual be taken by taxation and spent by the state on labor or goods, less will remain in the hands of the community with which to pay wages or to buy commodities on private account. These general truths must be qualified, of course, as to the rapidity of their operation. The condition of industry, the difficulty of effecting industrial changes, and the private losses arising from the inability of specialized ability or specialized capital immediately to obtain equally remunerative re-employment, must all be taken into account. But these are secondary details after all, necessary to correct the underlying truth, but not able to obscure or to change it. Perhaps the best exemplification of the ease with which in prosperous times vast transitions may be readily accomplished is seen in the sudden cessation in the government demand for services and commodities at the end of the late civil war, and the almost immediate and equal increase in the private demand for services and goods which happily had become available for purposes of peaceful industry. The dic-

tum that "every new tax creates a new ability in the subject to bear it" is distinctly limited by Hume as operative only within "certain bounds." It may perhaps be true that taxes which threaten the very existence of large classes might increase their industrial efforts.[1] Normally, however, the greatest stimulus to increased production is the assurance of freely enjoying what has been produced. We cannot too thoroughly emphasize the general truth that "the greatest promoter of industry is security"[2]— the assurance that "whatsoever a man soweth, that shall he also reap," without extortionate interference on the part of his neighbors or on the part of his greater neighbor, the state.

[1] Just as a fall in the rate of interest may stimulate the frugal to greater frugality.
[2] Bastable, Public Finance, p. 271 *sq.*

CHAPTER II.

TAXATION: ITS REAL AND APPARENT BURDEN.

The Incidence of Taxation.—The payment of taxes, involving as it does a diminution of such wealth as is individually disposable, is commonly recognized as a cost, a sacrifice, an expense. Yet certain facts might seem at first hard to reconcile with this general truth. For example, it must seem paradoxical at first sight that some who pay money into the hands of the tax-collector should be found protesting against the abolition of the very laws which require of them such payments. At times persons are even found agitating for an actual increase in the amount of taxation imposed upon objects which they themselves produce. Thus after our civil war the match manufacturers decried the proposed abolition of the tax on matches.[1] The manufacturers of whiskey in the United States have been notoriously active at different times to persuade Congress to advance the tax on their product.[2]

It needs but the slightest reflection to convince us that these demands are not prompted by public spirit. It is not benevolence but self-interest which they all betoken.

[1] See Seligman, Shifting and Incidence, p. 159 *sq.*

[2] Mr. Thomas G. Shearman in his recent monograph on Natural Taxation charges the Whiskey Trust with expending over a million dollars to induce Congress to exempt stocks of whiskey on hand when the tax on whiskey was advanced in 1894.

The immediate reason for this apparent willingness on the part of such producers to pay taxes is the belief that what they thus pay out will be recouped, perhaps with an additional profit, from the purchasers, who are expected thereafter to pay for the taxed article a higher price. The new price is commonly greater than the old price, and consequently a stock of goods on hand not subject to the increased rate of taxation is enhanced in market value by the newly imposed tax. The apparent taxpayer, the one who actually does advance money to the public fisc, is by no means always the real bearer of the burden. In the last resort the tax may be paid by one upon whom the tax is shifted through some process of sale or exchange. Taxes are often concealed in the prices asked for articles, and thus a storekeeper, as Mr. Wells says, frequently keeps on hand in the prices he asks for his goods "a lot of assorted taxes."

From this preliminary statement it becomes tolerably evident that the burden of taxation need not necessarily rest upon those who in the first instance advance money to the public treasury. We must distinguish the nominal payer, who advances the money for taxes, from the real payer, who actually bears the tax burden. And inasmuch as an ideal system of taxation must have regard to the way in which various social classes are affected by taxation, it becomes imperative to study the final location or "incidence" of taxes, as well as the process of "shifting" by means of which the burden is sometimes, in subtle ways, transferred from one person to another.

The Concentration Theories of Incidence.—Most explanations of this process of the shifting of taxes may be grouped about one or the other of two opposing principles. First, there are those who have maintained that the

whole burden of taxation is shifted upon some particular class in the community. Second, there are those who hold that taxes are borne alike by all classes, by everybody in general and by nobody in particular. This last doctrine has been called the Diffusion Theory; and by contrast we might call the other the Concentration Theory. The adherents of the Concentration Theory have by no means agreed as to the class that was so singularly vexed by taxes. John Locke, for example, held that "taxes, however contrived, and out of whose hands soever immediately taken, do, in a country where the great fund is in land, for the most part terminate on land."[1] The proof offered in support of this contention was simple. The laborer cannot bear taxes, for he lives now but from hand to mouth. The trading part of the community will shift taxes imposed on them by advancing their prices, and as there is no one else to bear taxes but the landlord, on the landlord must the taxes finally fall. There seemed to be a very general agreement for a time upon the comparative readiness of landowners to bear the brunt of taxation. Walpole, for example, is on record as saying that "landed gentlemen are like the flocks upon their plains who suffer themselves to be shorn without resistance; whereas the trading part of the nation resemble the boar who will not suffer a bristle to be plucked from his back without making the whole parish to echo with his complaints."[2]

This doctrine of Locke's that the landowner was the sole supporter of taxation was virtually reaffirmed by the Physiocrats, and with certain exceptions by Adam Smith, although he used a somewhat different line of

[1] Some Considerations on the Consequences of Lowering the Interest and Raising the Value of Coin, 1691.

[2] Cf. Sinclair, History of the Public Revenue, Vol. III., Appendix, p. 79.

argument. The vexed question was taken up later by Ricardo, whose method and some of whose conclusions in this matter still command general assent. He inclined, however, to the belief that the profit-recipient, the manufacturer and the merchant, were the great sufferers by taxation. Smith is "the advocate of the landed interest," Ricardo "of the moneyed interest."[1] The Concentration Theories are universally regarded to-day as one-sided, though frequently their defect consists in the narrow and rigid assumptions on which they are based rather than in defective reasoning in exploiting their logical implications. Their comparative validity will be involved in the formulation of the definitive theory of incidence and need not detain us here.

The Diffusion Theory of Incidence.—This theory asserts that, irrespective of the payment of taxes in the first instance, all economic classes alike are finally made to share the burden of taxes, and that, too, in some fair proportion to their respective ability. "Taxes," says Mr. Wells,[2] "equate and diffuse themselves, and if levied with certainty and uniformity, they will, by diffusion and repercussion, reach and burden all property with unerring certainty and equality." The Diffusion Theory owes its name to Thiers, the French statesman, who compared this supposed propagation of the burden of taxation throughout the industrial structure to the analogous optical phenomenon of the diffusion of light. The theory owes its first vivid statement to Lord Mansfield, who in 1766, in a speech upon taxing the American colonies, remarked: "I hold it to be true that a tax laid in any place is like a pebble falling into and making a

[1] Seligman, Shifting and Incidence of Taxation, p. 120. This study of the subject is valuable on both its historical and its theoretical side.

[2] Lalor's Encyclopedia, article on Taxation.

circle in a lake, till one circle produces and gives motion to another, and the whole circumference is agitated from the centre." This idea of the diffusion of taxes was systematically developed by Canard, a French economist, in a work published about the beginning of the present century.[1] He compares taxation to the cupping of a vein. This process causes no particular dearth of blood in the particular vein tapped, inasmuch as the adjoining veins contribute to make good the loss. Courcelle-Seneuil similarly likens taxation to the influence of the climate or the rain which falls alike upon the just and the unjust.

Some one has said that it is a merit of the jests of Erasmus that they can all be translated into arguments. Many will doubtless feel that it is a defect common to the arguments for the equitable and automatic diffusion of taxation that they may all be translated into jests. This whole theory rests either upon unproved assumptions or misleading analogies. A candle in a dark room does not equally illumine all parts of the room, however diffused the candle's light. The centre of a pond is more violently agitated by a pebble flung therein than are the more distant parts of the pond's surface. It is not altogether a matter of indifference what vein is opened in the process of cupping. But enough of these analogies. Indeed the only really serious attempt to demonstrate the theory of diffusion was made by Canard. He asserts that every tax laid upon any particular object will be borne in part by the producer and in part by the purchaser. Thus, finally, the burden will be fairly apportioned between these two typical social classes, and hence throughout society at large.

[1] Principes d'Économie Politique.

The Diffusion Theory, if accepted, very naturally leads to optimism in the matter of taxation, assuming as it does an automatic tendency in taxes towards perfect adjustment, provided only that time be allowed for this process to work itself out. As a corollary it follows that old taxes, like old wine, are better than new. They have equated and adjusted themselves.

Perhaps the readiest refutation of this theory and its implicates is to show that one important class of taxes is never shifted at all. Take the case of production under monopoly conditions. Suppose A. B. has a copyright upon a book for which there is a large demand. The book is put upon the market at a price fixed not merely to afford a margin over the expenses of publication, but so as to yield the greatest net return. Not uncommonly this price will be the only price which will yield the maximum net profit. A higher price will diminish sales, and thus cut down the net gain. A lower price will increase the sales, but not sufficiently to cover the increased expenses involved in the larger output. If in this case or in all similar cases a moderate tax, based upon a certain percentage of the net profits, be imposed, such a tax cannot be shifted in whole or in part. To advance the price or to lower the price are both alike economically impossible. The result is that the tax diminishes the monopoly profits and produces no other effects. The field of monopoly production in the world of to-day is already large and is rapidly growing. A theory of taxation, therefore, which is wholly inapplicable to so important an economic domain can hardly be an adequate explanation of incidence. The same truth—that certain taxes are not shifted—might be abundantly proved from economic history. But there is hardly need of additional evidence to dissipate the easy-going optimism of

the Diffusion Theory. As Roscher[1] wisely says: "A state which lays vicious taxes and trusts to the remedial power of shifting takes a leap into the dark."

The Definitive Theory of Incidence. — Probably the readiest way to cut to the heart of the current theory of the incidence of taxes is to take up the discussion of the simple case of a tax imposed upon the manufacturers of some particular commodity. Let us assume then that the distillers of whiskey are required to pay a tax of fixed amount upon every gallon of whiskey they make. We may assume also for the sake of the argument that all whiskey is of one uniform grade and has been untaxed hitherto. Now it may chance that whiskey is produced under (*a*) competitive conditions, or under (*b*) monopoly conditions. By the first we mean that the selling price of whiskey is normally determined by the expenses of producing whiskey. There may be different expenses of production, according as superior skill or better machinery or more advantageous location is utilized. But in the long run the selling price must cover the expenses of those distillers who produce at the greatest expense per gallon. Unless their sales yield them a living as good as similar energy would yield in other lines they will abandon the distilling business. In case their sales do not cover their expenses they will fail and will be forced out of the business. By monopoly conditions, on the other hand, we imply that the selling price is determined, not by the maximum expenses of production, but is set at such a figure that the sales at the price fixed will yield the greatest net profit.

First, let us consider the case of competition. If a tax of a dollar a gallon were suddenly imposed upon the

[1] Finanzwissenschaft, p. 182.

whiskey distillers, their first impulse would be to increase the price of their whiskey to the buyer, and so to saddle him with the tax. However, the distillers would thus run the risk of finding their sales shrink. Large stocks would probably be left on their hands unsold. This is but the exemplification of the fundamental law that price and demand vary in opposite directions. It is clear also that the distillers' ability to advance their prices will depend largely upon the readiness of the whiskey buyers to concede the increased price; or, in the technical language of Economics, the producer's ability under the given circumstances to raise the market price will depend upon the elasticity of the demand for the article.[1] In a community of confirmed topers perhaps the price could be increased a dollar per gallon—the full amount of the tax. Indeed the history of the internal revenue[2] during our civil war showed pretty conclusively that, gauged by the test of relinquishment, the consumers of distilled spirits regard their liquor pretty much in the light of a necessity. In the degree, then, that the taxed article is regarded as a necessity for which there is no substitute the producers will be able to shift the burden upon the consumer. In the degree that purchasers incline to lessen their use of the taxed article will the producer be unable, at least at first, to shift upon consumers the whole burden of the tax. In the one extreme[3] the new price will be the former price increased by the tax; in the other extreme the new price will be for a time the same as the former price. We must by no means overlook certain important collateral effects of this tax we have supposed to be levied on whiskey.

[1] Cf. Marshall, Principles of Economics, Bk. III., Ch. IV.
[2] Cf. Wells, Practical Economics, p. 181 *sq.*
[3] Assuming the cost of production constant per unit of product.

Where the producer is able to shift the whole burden upon the consumer the purchasers of whiskey who buy at the increased price will have a smaller portion of their income than formerly to exchange for other goods. Their demand for other products will usually fall off, and will thus injure, at least temporarily, other lines of productive enterprise. While these collateral effects are sure to follow, it is difficult to predict where and how they will occur. But we have a clue to the effects thus diffused throughout a wide circle of industries when we come to consider the collateral effects produced, when our typical producers, the whiskey distillers, are unable to advance their prices by the full amount of the tax. Before the imposition of the tax the price received for whiskey just afforded a living to those producers least advantageously circumstanced. The new price is now higher than the old price, but by less than the amount of the tax. Consequently those distillers who were just on the margin of profitable production will find that their sales no longer cover their expenses. They will consequently be forced to withdraw from the business. The new price[1] will thereafter just remunerate such producers as remain on the margin of profitable distilling. The tax has become a veritable portion of the marginal expenses of production which thereafter set the current normal price for whiskey. In both cases, then, when the pro-

[1] The discussion in the text assumes the cost of production per unit to be constant. More exactly we may say that when an article is produced subject to the law of diminishing returns, a diminished supply will be forthcoming at a lower cost per unit; so that with the tax added the new price will exceed the former price by less than the amount of the tax. Similarly, if the article produced obeyed the law of increasing returns, the new price would exceed the former price by more than the amount of the tax. On this point see Seligman, Shifting and Incidence of Taxation, p. 147 *sq.*

ducers shift the tax without lessening the output, and when they shift it, after having lessened their output, *the tax becomes a part of the expenses of production and must ultimately be borne by the consumer.*[1] The evil effect upon other industries or upon the former marginal producers of whiskey will be temporary, though, as Mr. Cannan[2] says, "'temporary' depression is a very permanent thing to those who are crushed out of a trade by it." Nor ought we to overlook such unnoticed collateral effects as result from the decreased use of the taxed article owing to its increased price. Many former consumers must curtail their consumption. Some must forego it altogether,—a result which we might contemplate with complacency as regards whiskey, but which is just as liable to take place in the case of necessary or useful articles.

Throughout the discussion we have been assuming the existence of competitive prices. It remains to speak of the incidence of taxes imposed on articles sold at monopoly prices. If a tax of fixed amount, as before assumed, be imposed upon each unit of the product, the monopoly producer cannot ordinarily escape the pressure of taxation altogether. He may sometimes minimize his loss, and at the same time impose on the consumer a heavy share of the tax load. Let us suppose, for instance, that the manufacturers of a caligraph, protected by patents, could market yearly 10,000 instruments at 70 dollars apiece;
20,000 instruments at 60 dollars apiece;
30,000 instruments at 50 dollars apiece.

[1] The careful formulation of the theory of incidence shows that such assertions as "the consumer always pays the tax" or (as regards taxed imports) "the foreigner pays the tax" are fallacious when unqualified, the latter indeed more frequently than the former.

[2] Elementary Political Economy, p. 147.

We may assume also that certain economies in production could be employed so that the expenses of production per machine would be less, the greater the total output. Let us assume that the plant could turn out 10,000 machines at a cost of 35 dollars per machine; 20,000 machines at a cost of 30 dollars per machine; 30,000 machines at a cost of 28 dollars per machine. Under these assumed conditions we shall have the following results:

Output.	Gross Receipts	Expenses of Production.	Net Profits.
(A) 10,000 at $70	$700,000	$350,000	$350,000
(B) 20,000 at $60	$1,200,000	$600,000	$600,000
(C) 30,000 at $50	$1,500,000	$840,000	$660,000

Under these conditions the lowest of the three prices, namely $50 per machine, will give the monopoly producer the greatest net profit. But suppose a tax of $10 per machine be imposed on the producer, then we shall have the following results:

Output.	Gross Receipts.	Expenses of Production.	Net Profits.
(A) 10,000	$700,000	$450,000 ($45 each)	$250,000
(B) 20,000	$1,200,000	$800,000 ($40 each)	$400,000
(C) 30,000	$1,500,000	$1,140,000 ($38 each)	$360,000

Under the new conditions the highest net profit will be had when the output is reduced from 30,000 to 20,000 (case B). The tax will have the effect of reducing the profits of the producers, but at the same time the purchasers of the machine will suffer, first, in that the number of would-be purchasers is cut down from 30,000 to 20,000; and second, in that each purchaser hereafter will have to pay $60 for each instrument instead of $50 as heretofore. Unlike the effect of mercy, the tax injures "him that gives and him that takes."

Suppose, on the other hand, that the monopoly pro-

ducers were taxed ten per cent. of their net profits, then we should find the case to stand thus:

	Net Profits as before the Tax.	Diminished by the Tax.
(A)	$350,000	$315,000
(B)	$600,000	$540,000
(C)	$660,000	$594,000

Hence the maximum net profit would be obtained by maintaining the largest output and the corresponding (lowest) selling price. The consumer would not be in the least affected, and the monopoly producer would bear the tax in its entirety.[1]

We conclude, therefore, that a tax upon each unit of an article produced under monopoly conditions may be borne in part by the purchaser, and that there is no assurance that the monopolist will bear the entire tax, unless the tax is levied upon the net profits, or in such fashion as to preclude the curtailment of the supply.

From this preliminary study of both competitive and monopoly production we may draw the following general conclusion: *The shifting of a tax by the producer upon the consumer depends on the possibility of the producer's restricting the supply of the commodity or service upon which the tax is levied.*[2] The hindrances to restricting

[1] Practically the same effect would follow were a percentage tax levied on the monopoly's gross receipts, provided, of course, that the tax be not so excessive as to reduce the net profits below the level of profit in competitive undertakings, in which case some of the capital might be withdrawn from the enterprise. Mr. Ralph W. Cone has called my attention to the fact that for a tax of less than $6 the producer would bear the entire burden.

[2] "L'impôt reste à la charge de celui qui le paye, si l'objet sur lequel il est assis n'est pas susceptible de réstriction. Il est rejeté en tout ou en partie sur d'autres contribuables, si l'objet est susceptible de réstriction."—de Parieu, quoted by Roscher, Finanzwissenschaft, p. 179. See also Wagner, Finanzwissenschaft, II., p. 353 *sq.*, for a fuller statement.

the supply may be physical hindrances. Thus the supply of land in the heart of a city cannot be restricted.[1] Sometimes the hindrance is economic in its nature. Thus a tax imposed upon the profits of a monopoly product (such as the caligraph just mentioned) cannot be evaded by a restriction of the supply, inasmuch as a diminished output would result in a greater loss to the producer than is occasioned when the producer bears the entire tax.

Application to Various Classes of Income. — If all taxes were levied upon the producers of manufactured goods, the problem of the incidence of taxation would be comparatively simple. We should obviously require to know, first of all, what goods various individuals or social classes consumed. We should next inquire which of these goods were manufactured under competitive conditions and which under monopoly conditions. Finally, we should have to satisfy ourselves whether there were in force any special circumstances which would tend to modify the general rule as to the shifting of taxes. If there were no such disturbing elements to be allowed for, we could pronounce with some certainty an opinion as to the location and the weight of the tax burden as between producers and consumers. Even here we ought to remember that each individual is ordinarily both a consumer and a producer; we ought to regard him in each capacity, and if necessary strike a

[1] For this reason Mr. George is right when he maintains that a tax on pure economic rent cannot be shifted. Mr. Edward Atkinson is in error upon this point. Prof. Charles H. Hull in a valued criticism on this matter of shifting of taxation, urges forcibly that it would be more exact to put the matter thus —" The possibility of shifting depends upon the possibility of the producer's raising the price, instead of restricting the supply." But in the last resort the raising of price depends on restricting supply except only where the demand for an article is absolutely rigid.

balance before making our final estimate of the pressure of taxation he sustains.

Unfortunately the actual problem of incidence is not as simple as this. While much of our public revenue comes from the taxation of commodities in the hands of the producer or the importer (indirect taxes), even more is raised by taxing individuals irrespective of what they consume, on the basis of the property they own or the income they receive. Even here the preceding case gives us a clue by which we may discover, in a general way, how far such taxes (direct taxes) are shifted. In general we saw that the possibility of the producer's shifting a tax depends on his power to restrict the supply. What holds good of one commodity produced for the market holds good of the contributions made by various property-owners and income-recipients to the social income or 'National Dividend.' Incomes [1] are ordinarily derived from the production of commodities or the rendition of services. Sometimes an individual's income is from both sources. When, therefore, a class of individuals is taxed, they will bear the burden of the tax unless they can restrict the supply of goods furnished or services rendered by them. In a general way taxed incomes derived from monopoly sources are likely to bear the burden of taxation. Incomes derived from competitive sources will escape the burden of taxation

[1] If income be taken in the widest sense, as the flow of economic advantages per unit of time, the benefits derived from the actual use of wealth by the owner is a part of his true income. If a man lives in his own house, the comfort and shelter it affords are parts of his real income. If A lets his house to B, A is making a contribution to the social income, as much as though A manufactured iron goods. If wealth thus used, or income-yielding property (in contradistinction to productive capital in the narrower technical sense) be taxed, the income it yields is curtailed, and there is no way in the immediate present by which such a tax can be shifted.

in so far as such sources of income are curtailed. In static conditions such monopoly incomes as are derived from pure economic rent or from superior personal abilities will be saddled with the burden of taxation. Incomes derived from invested capital must suffer from taxes imposed thereupon, unless the capital can be withdrawn[1] and reinvested in more advantageous ways, or until restricted investments raise the income from such capital. Taxes imposed on wage incomes (unless skilled abilities limited in supply give a quasi-monopoly wage) can only be shifted when the supply of labor is decreased. This implies a checked growth of the numbers of unskilled workmen—a process which is generally slow and always more or less uncertain, although freedom of movement aids in cutting down the over-supply of labor in given localities.

Besides the general conditions laid down, any bar to the action of unrestricted competition between parties to avoid the brunt of taxation must modify the general principles of the incidence of taxation. In actual finance the question of the incidence of specific taxes must be determined by considering how far the general laws already enunciated are modified by concrete circumstances.

Supplementary Note.

There are certain problems which concern incidence as regards individuals rather than as regards typical social classes. Examples of such problems are the method of shifting taxation by capitalization. A certain piece of property is burdened with a tax. The tax re-

[1]An equal tax on all capital is a practical impossibility. If theoretically possible, the tax on the income from such investments could be shunted only by a general decrease in the growth of the future capital. Where debts secured by mort-

duces the net yield of the property in question, and consequently its capitalized value. So that a purchaser will ordinarily shift the whole burden of the tax upon the erstwhile owner by according a reduced price for the property. That is, the original owner cannot shift the tax by selling the property. Another analogous problem is presented by equal incomes similar in their economic origin. *Ceteris paribus* the burden imposed on each income will be the same. It may happen, however, that a great portion of one income is expended upon articles whose prices are largely taxes in disguise, whereas a small part or perhaps no part at all of the other income is expended upon such taxed products. In this case the amount of taxation borne by the first income is greater than that borne by the second. It is perhaps questionable whether this is of great importance for practical finance where classes must be dealt with as classes.

gages are practically the only kind of personal property taxed. the lender shifts the tax to the borrower by exacting a rate of interest high enough to cover the tax. See p. 126.

CHAPTER III.

TAXATION: ITS EQUITABLE DISTRIBUTION.

Nature of the Problem.—In the preceding chapter a matter of fact was discussed; in this chapter a question of right is involved. Where the stresses of the tax load are actually distributed throughout the economic structure is, in a general way, known. How this burden ought to be distributed is largely a matter of dispute. The question of public equity is nowhere freighted with greater significance than in the domain of taxation. The issue is an ethical one and of far-reaching importance. Thoroughly to exploit it would involve a searching analysis of the very foundations of morals. The question of equity in taxation is by no means wholly or principally a problem of the mere adjustment of administrative detail. Even current discussion of the Single Tax proposal or of the now defunct Income Tax could not content itself with surface generalizations. The very foundations of society, of private property, of liberty as now known to law, are challenged. Here as elsewhere the house economic is divided against itself, and the question of the distribution of taxation is a crucial question. It is "quick and powerful," and pierces "even to the dividing asunder" of collectivists who would fain retain the benefits of competition, and of individualists who perhaps regretfully shut their eyes to what they regard as the delusive dreams of a socialistic Utopia.

There are indeed those who deny that abstract equity can be regarded either in the framing of tax laws or in their enforcement. Cumbered with the multifarious worries of fiscal administration, they exalt the necessity or perhaps the convenience of the fisc into a guiding principle to which all else is subordinate and must conform. For them, as for Colbert, "the supreme art of taxation" is "to pluck the greatest amount of feathers with the least amount of squalling." Or, as McCulloch[1] more decorously puts it: "The characteristic of the best tax is not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is at the same time most conducive to the public interests."

This, however, is no solution of the problem of equity in taxation. It is rather the despair of finding any solution. A perfectly equitable tax system may be an unattainable ideal. But this does not absolve us from all effort making for approximate justice.

Broadly speaking, we may say that three generic schemes offer themselves as supplying norms of justice in taxation. These three are, respectively, Confiscation, Progression, Proportion. The confiscatory proposal is based upon the alleged injustice of certain kinds of private property and the incomes flowing therefrom. Redress these evils, it is urged, by restoring to society that which is rightfully its own, and taxation will take care of itself. This is the claim of Mr. George and his adherents. This is also the demand of those who would impose upon certain monopolies the entire burden of taxation.

The adherents of progressive taxation occupy a less extreme position. They concede it to be the duty of

[1] Taxation and Funding, p. 18.

practically all subjects of the state to make sacrifices for the state. But they would impose the heavier burdens upon the wealthy, and would thus exempt wholly or in part those who have but little. Lastly come those who insist upon the universality of the duty of supporting the government, but who would distribute the weight of taxation always in strict proportion either to the resources of the contributors or to the benefits they severally derive from the state.

The Confiscatory Theory.—The most famous of the confiscatory theories is Mr. George's proposal that pure economic rent [1] in its entirety be taken by way of taxation. This claim is based upon his contention that natural equity does not permit private property in land. It is at once evident that the issue here raised involves the basal principles of social organization. Mr. George's argument may be briefly stated as follows: The sole and ultimate justification of private property is rooted in "the right of a man to himself,[2] to the use of his own powers, to the enjoyment of the fruits of his own exertions. . . . As a man belongs to himself, so his labor when put in concrete form belongs to him." Only when these powers are embodied in a product is the product rightfully his. Land is not the product of human labor, and thus cannot rightfully be held in private ownership. Such a material product as a pen, for example, is rightly and absolutely and exclusively the property of its producer or of the one to whom the producer has transferred it.

[1] For those not conversant with ordinary economic terms it may be worth while to state that Mr. George proposes that such part of real estate incomes as are in excess of the interest upon the capital invested in improving the land or in building thereon shall be absorbed by taxes. He does not advocate the confiscation of the entire income from real estate.

[2] Progress and Poverty, p. 299 *sq.*

"No other human being can rightly lay claim to it." But no similar claim can be made for private ownership of land.

The obvious answer to Mr. George's allegation is cogently put by Prof. Sidgwick.[1] "Human labor is obviously not the cause of the matter of any material product, but only of its form; therefore, if a man is to have the right of property in the product, he must have already been allowed to appropriate the material; and this preliminary appropriation will require justification." This logical demolition of Mr. George's argument seems to me to be indefeasible. If private property in material chattels is justifiable, there is no reason *a priori* why private ownership of land may not also be justifiable. As Mr. Rae says, "Land is as much the creation of man as anything else, and everything is as much a gift of God as land." Whatever be the fundamental justification of private property, to maintain, as Mr. George does, that chattels may rightly be the subject of private property, but land may not, is to attempt at the same time "to hold with the hare and run with the hound." It is perfectly allowable, of course, to argue, as Mr. George subsequently does, that the well-being of society will be the better secured by the state's virtual acquisition of the soil. But to adopt this line of argument is in itself a change of venue. The proud claim of securing an immediate intuitive verdict from the supreme tribunal of natural equity against private landownership has been abandoned; and the case has thus been remanded to the lower court of social utility. The contention of the Single Tax advocates now takes this form.

[1] Political Economy, p. 503. Cf. also Grotius *de Jure Belli et Pacis*, III., iii., § 3; Huxley, Method and Results, Essays, p. 373; Rae, Contemporary Socialism, p. 448.

Taxation should absorb the totality of economic rent, because under the system of private landownership the entire increase of wealth must theoretically inure to the exclusive benefit of the landowner. Such, they claim, has historically been the case. That this is the contention of Mr. George is proved by the following extract[1]: "Land being necessary to labor, and being reduced to private ownership, every increase in the productive power of labor but increases rent, the price that labor must pay for the opportunity to utilize its powers; and *thus all the advantages gained by the march of progress go to the owners of land*,[2] and wages do not increase. Wages cannot increase; for the greater the earnings of labor the greater the price that labor must pay out of its earnings for the opportunity to make any earnings at all. The mere laborer has thus no more interest in the general advance of productive power than the Cuban slave has in an advance in the price of sugar."

If this presentation of the facts corresponded with the facts themselves, even Mr. George's remedy would hardly seem too high a price to pay for our economic regeneration. But both theoretically and historically Mr. George is in error. Every increase in productive power normally increases the demand for the various factors necessary to production. But in what proportion the demand for land, capital, and labor (both manual and directive) will increase is, in general, unpredictable. It is a gratuitous assumption, however, to assert that increased productive power will enhance the demand for land only.[3] Thoroughly to sift Mr. George's historical contention, that as a matter of fact the entire increase

[1] Progress and Poverty, p. 255.
[2] The italics are not in the original.
[3] Cf. F. A. Walker, Political Economy (Advanced Course), p. 419 *sq.*, for an examination of George's theoretical argument.

of productive power has exclusively benefited the landowning class, would take us too far afield.[1] The same must be said about his assertion as to the increase of poverty. This latter subject indeed hardly falls within the scope of Public Finance. Similar reasons also must bar out any discussion of the various compensatory or quasi-compensatory schemes of land nationalization. Suffice it to say that neither theoretically nor as a matter of common observation is the private ownership of land tantamount to the exploitation of the landless classes. The labor theory which Mr. George has erected is obviously untenable as a fundamental ethical basis for private property. His utilitarian argument for the necessity of the state's acquisition of land proves upon examination to be theoretically and historically inconclusive. Whatever then be the moral basis upon which private property in land is to be theoretically justified,[2] the confiscatory gospel of the Single Tax advocates can hardly be accounted an enlightened solution of the problem of the just distribution of taxes.

[1] Cf. Rae, Contemporary Socialism, Ch. XII., second edition; Seligman, Essays in Taxation, especially the examination of the Single Tax theory, Ch. III.

[2] The argument in the text in reference to the ethical basis of private property is entirely critical and destructive. Personally, I do not sympathize with the view very generally accepted by American economists that Social Utility and Right are convertible terms, and the same in essence. For the individual I hold that alone to be Right which realizes or tends to realize his personality as a rational being. Similarly for society that alone is Right which realizes or tends to realize the rational personalities of its constituent members. Now, Society like the individual is environed in a *milieu* where the struggle for existence prevails. This preconditioning law is inevitable. Private property I believe to be the most efficacious method yet devised to minimize the suffering involved in the struggle for existence. Private property thus secures the possibility for the greatest self-realization of the rational persons who constitute Society. This is, in my opinion, its moral justification. In short, felicific tendency is frequently an index or exponent of the Right, but is not Right in essence.

There are those who do not confine their attention to the taxation of economic rent, but who argue that rent is only a species of a large genus of gains—all of them unearned. Thus certain monopolized enterprises or speculative gains are to be singled out for taxation. Apart from the probable inadequacy of revenue so derived to meet the wants of the government, the objections to such a policy are weighty.[1] The speculative investment of capital in new enterprises is roughly based upon the average return thus obtainable. This average return is made up of hits and misses. The point is well illustrated by a story told of a prominent financier who, upon deciding to invest in a projected railroad, remarked that he would either lose a hundred and fifty thousand dollars or make a million and a half in the venture.[2] If every lucky investment is to be regarded as *prima facie* evidence of theft, or at least of unearned wealth, the average inducement to make such ventures will be materially weakened, and society will suffer no less than the individual who is thus fined for his ingenuity.[3] Moreover, when the source of monopoly or unearned profits has been once transferred from the original owner, special or exclusive taxation involves the expropriation of property owners who acquired their title by indefeasible right. Thus a lawyer may out of his professional earnings buy stock in a successful industrial company. The value of the stock may have been originally "unearned," but the present holder's moral title is not thereby affected. If society through the tax-

[1] Cf. Bastable, Public Finance, p. 309.

[2] He is said to have added that if he did the former, the public would say he was 'a d—— fool,' and if he did the latter, they would say he was 'a d—— thief.'

[3] Of course where public franchises are a source of unusual profits, special taxation may be only a just return for the privileges accorded.

collector is to mulct any one, it ought to be the original beneficiary of the rise in the stock's market value. It hardly requires to be said that fiscal administration cannot undertake as preliminary to the imposition of taxes the determination of the original equitable acquisition of property.

The Theory of Progressive Taxation.—However the taxpayer's ability be measured, whether by income or by property or by consumption, the theory of progressive taxation contemplates the exaction of a larger proportional slice from the greater means than from the lesser. This proposed canon of equity is supported on two distinguishable, though not always distinct, grounds. First, it is based upon what is called the politico-social theory of taxation; second, it is founded on the contention that progressive taxation is a more exact measure of ability than rigidly proportional taxation which takes the same fraction from all resources, be they great or small. The politico-social theory of taxation [1] is essentially an attempt to correct by means of progressive taxation the inequalities of the competitive distribution of wealth. The attitude of its supporters is Janus-like. They face both Collectivism and Competition. They hold that a little stealing is not a dangerous thing, provided the state commits the theft. This rule is unsound, because it is based on the idea that the state can beneficially interfere with economic distribution by acts which weaken the incentives to accumulation. The second claim which is made for the progressive principle is much more weighty. The rich, it is argued, are abler far to contribute to the needs of the state than are the poor. They are able, moreover, to contribute a larger proportional share of their total resources than are their less fortunately cir-

[1] Wagner, Finanzwissenschaft, II., p. 207 *sq.* and p. 405 *sq.*

cumstanced neighbors. Though the rich give more than the rest, both absolutely and relatively, still more remains at their disposal when the taxes have been paid in. As Paley [1] put it, "the point to be regarded is, not what men *have*, but what they can *spare*."

A careful preliminary definition of the taxpayer's ability will clarify the discussion of the moot question of progressive *versus* proportional taxation. It is evident that ability must in some degree be related to income. This latter term designates the amount of commodities received and services enjoyed within a given period. A man's income in its broadest sense includes the economic satisfactions received within a given period. Property itself is of value only as a source of income. It is not the only source, but it is one of the two ultimate sources, labor being the other. Income again must be differentiated into gross income and net income. The former is the total periodic influx of commodities and services, while the latter is determined by deducting from gross income all cost involved in its acquisition, excepting the exertion, if any, on the part of the recipient. For example, A is a manufacturer. His annual sales (gross income) amount to $100,000. His expenses of production are $85,000. His net income is $15,000. In many cases gross income and net income coincide. Thus an ordinary laborer's wages usually suffer no deduction for the tools he uses or the material on which he works.

Does equity in taxation then prescribe a strictly proportional levy upon net incomes or does it prescribe a rising rate upon the higher net incomes? Some allege that the higher net incomes should be assessed at the

[1] Elements of Political Knowledge, Ch. XI. He is here speaking of gross, not net, income.

higher rate, inasmuch as "to take 100*l.* from 1000*l.* is a heavier impost than 1000*l.* taken from 10,000*l.*"[1] It is not altogether easy to see any rational basis for such a claim. It is probably true that if a person A with an unchanged scale of wants and a fixed standard of living should at one time lose $100 out of $1000, he would feel the loss more severely than if he lost at another time (when his possessions were greater and his wants not enlarged) $1000 out of $10,000. In the first place, however, one's standard of living is almost certain to keep pace with one's income. And even if it did not, the argument is wholly inconclusive, inasmuch as *it assumes that what is true of the same man at two different times is true of two different men at the same time*, and that A would feel the loss of $100 out of $1000 more severely than B would feel the loss of $1000 out of $10,000. Until some better proof of this assertion is offered, one may well remain skeptical in regard thereto.[2] The higher net incomes are the usual concomitants of higher standards of living, and that a curtailment of the greater expenses would be less felt than a proportional retrenchment on the part of less pretentious establishments is open to the gravest doubt. The case, then, for progressive taxation cannot be said to be proved. Two qualifications, however, ought to be added: first, that any system of strictly proportional taxation based on net income would be essentially a species of progressive taxation. Very small incomes cannot prac-

[1] Mill, Political Economy, Bk. V., Ch. II., § 3. Mill is here speaking of gross income, however, and practically denies this contention except as applicable to the minimum of subsistence.

[2] It ought also to be said that no regard is here paid to the source of income as affecting the necessity of saving for the future. Equal net incomes (as defined) from landed property and from personal exertions are not perfectly fair indices of equal ability, for the latter stops with the death of the recipient, while the former continues.

tically be reached. Even if they could, the cost of tax-collection would make the attempt to reach them unwise. Practically this amounts to degressive taxation so called, namely the exemption of the minimum of subsistence. The second qualification is that a decision adverse to progressive taxation as a general system does not necessitate the rejection of specific progressive taxes among the constituent parts of a tax system. Thus a progressive income tax, such, for example, as one which exempts incomes up to a certain amount, may be a necessary correction of fiscal inequalities resulting from taxes upon the consumption of necessities which absorb a greater fraction of small incomes than of large.[1]

The Theory of Proportional Taxation.—We have found reason for rejecting confiscation and progression as norms of fiscal justice in the distribution of taxation. There remains the third scheme of proportional taxation. The first question which arises in regard to proportional taxation is, *proportioned to what?* In very young economic communities a rough approximation to justice is attempted by laying taxes in proportion to numbers, and by taxing every man alike. This is a primitive poll-tax. But, as Bentham[2] says, "because a man has a head, it does not follow that he has anything else," and the unfairness of such a distribution of taxes is soon apparent. According to what then ought taxes to be proportioned? In this matter one may readily subscribe to what is essentially Prof. von Helferich's[3] view, which

[1] Another powerful objection to the progressive taxation is that it renders impossible the administrative method of "stoppage at the source." See p. 186 and p. 189.

[2] Principles of the Civil Code, Ch. XV.

[3] Schönberg's Handbuch, Vol. III., p. 136 *sq.* Prof. v. Helferich distinguishes between the necessary and optional functions of government.

may be stated thus: *Government benefits when general in character and incapable of measurement or allotment should be paid for from taxes levied on the basis of the subject's net resources: government benefits when concrete, specific, and measurable should be paid for by the individual recipients of such benefits.* There are certain offices which the state performs which are advantageous to all its subjects. Such are the protection of life and property. It is futile to try to determine what individuals or classes are most (or least) benefited by such state services. "Government," as Mill[1] says, "must be regarded as so pre-eminently a concern of all, that to determine who are most interested in it is of no real importance." As it is impossible to measure the relative advantages derived by various classes of individuals from such public services, it seems a fair presumption that the same proportional deduction from each one's net resources is as fair an approximation to what Mill calls "equality of sacrifice" as can reasonably be attained. Hence the first part of the canon.

On the other hand, it would be folly to ignore the fact that certain government services do specially and specifically benefit particular individuals mainly or perhaps exclusively. Thus a municipality paves a street and benefits to a large extent the abutting property owners. Or it grants a local transit company a franchise and thus assures the corporation a paying business. Or a postman is sent to deliver a special delivery letter, and the sender is the particular beneficiary. In these and similar cases the benefit afforded is largely specific and its cost is measurable. In such cases, therefore, there is good

[1] Political Economy, Book V., Ch. II. See here Mill's refutation of the idea that relative benefits can be measured by the respective incomes enjoyed under the protection of the state.

reason for exacting the price of the service or the afforded privilege from the one thus signally advantaged.

Supplementary Note.

The further question may be asked whether the price charged by way of a tax or quasi-tax ought to be graduated so as merely to cover the cost of service (or the value of the public rights surrendered), or whether the tax should rise above this margin, if possible, so as to measure the advantage conferred on the beneficiary in question. For example, suppose the average cost of special postal delivery to be ten cents per letter, and suppose that a charge of fifteen cents per letter could be exacted without any sensible diminution in the demand for such postal service. Which rate ought to be asked ? This, I fancy, is a question which must be determined by a large number of collateral considerations, such as the current need of revenue, the indirect effects of such public services, the general character of such letters—commercial, social, or otherwise. In general, however, it ought to be remembered that the government has no interest analogous to that of a private firm in making a net profit out of the enterprises it conducts. Provided the cost is covered, the sacrifice of net profits corresponds to an increase in the " consumer's rent " obtained by the one who employs the government agency.

CHAPTER IV.

TAXATION: ITS PRACTICAL EFFICIENCY.

Adequacy of Tax Revenue.—Up to this point we have studied taxation mainly on its outer side. That is to say, we have viewed taxation primarily as an objective economic phenomenon, and have not asked what rules should guide the financier with whom rests the origination or the execution of tax laws. At this point we take up the subject of taxation on its inner side, as it were, and inquire what principles must guide the legislator and finance minister in this business of raising revenue. The general features of taxation he must, of course, understand. The essential nature of a tax, its processes of shifting, the applicable norms of equity—all these constitute an indispensable part of a financier's equipment. But they are rather the postulates on which he acts than the problems which immediately press upon him for solution. *The paramount demand which a practical financier makes upon any tax system is that it furnish revenue sufficient for public needs.* It is indeed desirable that a tax system be popular; it is important that it be just; but it is absolutely essential that it furnish adequate revenue. Adequacy in finance is like charity among the virtues. Its absence renders all collateral excellences as nothing, and its presence covers a multitude of sins. It therefore becomes a matter of prime importance to determine, first, how a tax system is to be constituted

which will afford the requisite amount of revenue; and secondly, to determine how to administer such a system most advantageously, having regard to the interest both of the public treasury and of the individual taxpayer.[1]

Single and Multiple Tax Systems.—If we approach this subject from a purely *a priori* standpoint, nothing would seem more natural than that the aggregate amount taken by taxation should be raised by a single, uniform process, rather than collected by multiple, imperceptible, and devious agencies.[2]

We have seen that taxation is in essence a diminution of the amount of income at the disposal of the individual. It does not increase the amount that is deducted from individual enjoyment and use to take it in a single lump sum, or, at least, to take it by a single, uniform process of collection. Indeed there is, it would seem, good ground for believing that actually less would be taken from the taxpayer if tax collection could thus be more economically prosecuted. How then are we to explain the seeming anomaly that everywhere there is a multiplicity of taxes and a variety of methods of tax collection ? No more vivid picture of a plague of taxes has ever been given than by Sydney Smith,[3] who described the English

[1] Wagner entitles his two politico-financial canons of taxation Adequacy and Elasticity. Cf. his Finanzwissenschaft, Vol. II., p. 304. To a certain extent one implies the other, but inasmuch as exceptional needs of the fisc are met both by increased taxes and by loans, I have judged the matter of Elasticity may be properly treated under the discussion of equilibrium between Income and Expenditure.

[2] A single tax system, it must be understood, does not necessarily involve an exclusive tax upon any one particular object of wealth such as land. Mr. George proposed to tax only rental values, it is true, but this is but one out of many possible single tax schemes. If all taxes whatever were raised by a single assessment upon general property alone, we should have an example of a single tax system.

[3] Edinburgh Review, 1820, Vol. 33, p. 77.

tax system in force after the Napoleonic struggle as follows: "We can inform Jonathan what are the inevitable consequences of being too fond of glory;—TAXES on every article which enters into the mouth, or covers the back, or is placed under foot—taxes on everything which is pleasant to see, hear, feel, smell, or taste—taxes upon warmth, light, and locomotion—taxes on everything on earth, and the waters under the earth—on everything which comes from abroad, or is grown at home—taxes on the raw material—taxes on every fresh value that is added to it by the industry of man—taxes on the sauce that pampers man's appetite, and the drug which restores him to health—on the ermine which decorates the judge, and the rope which hangs the criminal—on the poor man's salt and the rich man's spice—on the brass nails of the coffin, and the ribands of the bride—at bed or board, couchant or levant, we must pay:—The schoolboy whips his taxed top—the beardless youth manages his taxed horse, with a taxed bridle on a taxed road:—and the dying Englishman, pouring his medicine which has paid 7 per cent., into a spoon that has paid 15 per cent.—flings himself back upon his chintz-bed which has paid 22 per cent.—makes his will on an eight pound stamp, and expires in the arms of an apothecary who has paid a license of a hundred pounds for the privilege of putting him to death. His whole property is then immediately taxed from 2 to 10 per cent. Besides the probate, large fees are demanded for burying him in the chancel; his virtues are handed down to posterity on taxed marble; and he is then gathered to his fathers,—to be taxed no more." [1]

The seeming absurdity of such a multiplicity of exac-

[1] For a somewhat similar characterization of the tax system of the United States, see D. A. Wells, Cobden Club Essays, second series, p. 479.

tions, no less than a true perception of the increased burden such a number of taxes imposes, has led to various proposals for a simplification and a unification of taxes. Vauban (1633–1707) proposed in the reign of Louis XIV. to establish a tax known as the royal tithe or *dîme royale* which, while it was not to supersede all other taxes whatever, was intended to replace an harassing multitude of fiscal levies. Again at a later period the Physiocrats projected the *impôt unique* as a substitute for the vexatious swarm of taxes which weighed down the French taxpayer. Both Turgot and Mirabeau, however, admitted the impossibility of abolishing at that time all other taxes. Recognize, as we must, the theoretical shortcomings of the Physiocrats, especially in their identification of the material surplus of extractive industry with the only source of taxation, it is still impossible not to have a generous sympathy with the rational principle which lay at the basis of their faith. Compared with the administrative pettifogging and the shortsighted pedantry which marked the cumbrous mass of fiscal anomalies then prevalent in France, their clear-cut plans and sweeping designs for financial reorganization have the broad and permanent traces of political genius. If experience allowed us to harbor the hope of peoples more enlightened and of governments less extravagant, a single tax system might be perhaps realized. Such a project to-day is an Utopian ideal, but a captivating ideal none the less.

The practical difficulties which prevent the realization of a single tax system are, the danger of gross inequality in the distribution of taxes under such a régime, the necessity of suiting taxes to the convenience of the taxpayer, and the difficulties, in the United States at least, which would attend upon the disbursement of revenue

among different governmental units. The inequalities which would arise if all taxes were levied upon articles of consumption, for instance, are readily imagined. People of smaller means would bear more than their proportionate share of the general burden. Similarly, if money incomes alone were taken as the sole basis of taxation, much ability to contribute to public needs would escape. No matter how broad the basis chosen, it seems certain that great inequality would result from any single tax system. While viewed abstractly, therefore, a number of different taxes may seem an unnecessarily cumbrous piece of financial machinery, yet such a number of taxes, if kept within due bounds, guarantees a sort of compensatory action which, if it does not secure perfect equity, at least prevents the grossest inequality. The second cause given for the non-establishment of a single tax system is the necessity of suiting taxes to the convenience of the taxpayer. This is a desideratum prescribed by considerations of securing smooth administration no less than by considerations of adequate revenue. Roughly speaking, there is no criterion of the convenience which a tax system affords the taxpayers comparable with their general acquiescence in such a system. Such acquiescence may be dictated by motives of inertia, interest, or ignorance. But so long as these continue to be traits of human character, and so long as we confine ourselves to viewing things as they are, rather than as they ought to be, there is no material error in saying that of two tax systems which exact substantially the same amount of objective wealth from a community, that which is the more popular is felt to impose the lesser burden. Indeed the greater satisfaction on the part of the general public may even offset what, objectively viewed, is a greater real burden of taxation.

This it is that compels modern states to have so large a recourse to what are termed indirect taxes—that is to say, taxes levied in general upon consumable commodities. These taxes normally fall, as we have seen, upon the consumer. They stand in no necessary relation whatever to his taxpaying ability. But for a number of reasons shortly to be given they are in the eyes of the taxpayer more convenient than direct taxes. They come in the disguise of the prices of commodities, which the taxpayer seems to regard with comparatively little aversion. In taxation, as elsewhere, "people like to be humbugged." Even aside from considerations of equitable distribution, a single tax system would impose too severe a strain upon the moral nature of ordinary humanity. The amount taken from the individual's income by taxation is so considerable in the aggregate that, however economical and reasonable a plan might seem, which would take this amount once for all in a lump sum, there is absolutely no chance of securing for such a project anything like popular approval. The taxpaying multitude is like Issachar—"a strong ass crouching down between two burdens," one of which is the necessary load of taxation, and the other the unnecessary encumbrance imposed by their ignorance of the nature of taxation.

The third reason for the non-establishment of a single tax system is the difficulty which under our form of government would arise in the allotment of revenue between the federal and the state governments. If either were exclusively charged with the collection of the tax, the other would soon become politically dependent. If each continued in partial independence of the other to raise taxes, it is difficult to see how a single tax system could be steadily maintained.

Construction of a Tax System.—The foregoing con-

siderations force us to acknowledge the practical necessity of a complex or multiple tax system instead of a single tax system. Resort must be had to both direct and indirect taxes. It, therefore, becomes necessary to consider the respective merits and defects of these two kinds of taxes. The very terms have been used at various times in various senses. Nor is it our intention to grope longer than necessary in the dialectical bog in which their meanings have been obscured or buried.[1] Originally a direct tax was one whose real burden was borne by the payer in the first instance. An indirect tax was a tax which the payer shifted upon some one else. This was essentially the sense in which the Physiocrats employed the terms. Unfortunately some of the Physiocratic ideas as to what taxes were shifted and what taxes were not shifted proved untenable. Thus it happened that, while the old terms were retained, some taxes which was originally supposed to be unshiftable and therefore direct turned out to be shiftable and therefore indirect. Thereupon a more cautious distinction was made. John Stuart Mill[2] put it as follows: "A direct

[1] No better example of a long-winded contention about the proper meaning of the terms "direct" and "indirect" can be cited than the recent arguments before the Supreme Court in the income tax cases. The term "direct taxes" in the federal Constitution was supposed to have a specialized and technical meaning, to wit, land-taxes and capitation taxes *eo nomine*. History was ransacked and philology tortured to make the term mean something else. Whatever other effect the court's decision may have had, it seems to have brought the legal definition of the term into consonance with current economic definitions, athough this was done by traversing former decisions which had intimated strongly that only taxes imposed on individuals as such, and land as such (not as a possible or probable source of income), were "direct taxes" within the meaning of the Constitution. For a discussion of the various uses of the terms see article by Dr. Charles J. Bullock in Political Science Quarterly, Vol. XIII., No. 3.

[2] Principles of Political Economy, Book V., Ch. 3.

tax is one which is demanded from the very persons who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another." Here the intention or desire of the legislator is made the determinant factor in deciding whether a tax is direct or not. Both the earlier and the later criteria used to distinguish direct from indirect taxes are inadequate. The incidence of taxes cannot always be nicely and certainly predicted. Besides, their immediate incidence and their eventual incidence may be different. Hence the impossibility of making incidence the test of the distinction. The intention of the legislator as regards incidence, even if the intention could always be ascertained or presumed, affords a poor basis of distinction. The motives of the legislator in enacting tax laws are complex. The probable incidence of the tax is but one of many considerations which influence his action in the matter. It may influence him to a very small degree or to no degree at all. It therefore seems best to adopt the empirical classification made by administrative officers and the general public as well, and to classify taxes accordingly. It must be admitted that administrative and popular usage in different countries differs in certain details. It seems best, however, to note such differences, and to treat them accordingly when dealing with taxation in the concrete, rather than to refine upon existing definitions or add new definitions to the already cumbrous list. Direct taxes may then be described as regularly recurring exactions made upon the basis of existing possessions or occupations, whose collection is ordinarily initiated by the treasury officials who are furnished with lists of the tax objects or taxpayers. Indirect taxes are

irregularly recurrent exactions made upon the basis of new acquisition, purchase, consumption, or use, whose collection is primarily occasioned by the individuals who thus newly produce, acquire, purchase, consume, or enjoy certain kinds of goods. Hence a tax on existing property, either as an undifferentiated whole or on specified parts thereof, or a tax on the income derived therefrom, or from pursuits or trades of some time standing, are examples of direct taxes. Taxes on the importation of goods, or on the manufacture of goods, or on the occurrence of certain specified transactions, such as the recording of deeds or the inheritance of property, are indirect taxes. Curtly put, direct taxes are taxes on outstanding possessions; indirect taxes are taxes on new acquisitions.

Properly to apprehend their respective merits and defects it is necessary to consider them from a number of standpoints. These standpoints in the order of their importance are: (1) the financial productiveness of the two, (2) their industrial consequences, (3) their influence on the distribution of the tax burden, and (4) their political tendencies.

Their Financial Productiveness.—The relative amount of revenue derived from these two classes of taxes respectively, varies from one nation to another. In the United States the amount derived from indirect taxes is less than the aggregate derived from direct taxes, although the federal government's receipts come almost exclusively from the first source. Of all nations Switzerland derives perhaps the greatest proportion of its revenue from direct taxes. The first fact, however, to deserve careful attention is not the variable proportions yielded in different states by these two kinds of taxes, but rather the universal recourse

which all states have to both of them. Gladstone once described direct and indirect taxes as two sisters,—the offspring of Necessity and Invention,—"differing only as sisters may differ,—the one being more free and open, the other somewhat more shy, retiring, and insinuating"; and frankly confessed that, whether from "a lax sense of moral obligation or not," he, as Chancellor of the Exchequer, "thought it not only allowable but even an act of duty to pay his addresses to them both." This universal utilization of direct and indirect taxes goes to show the necessity, or at least the preponderating convenience, of employing them both. This is due to a number of causes, one of them being the very considerable amounts annually spent by governments. We are here concerned, however, to trace only the reasons why both kinds of taxes must be used to afford adequate public revenue. Were direct taxes alone employed, a large part, often the larger part, of the population of the state would escape taxation altogether, except in so far as the taxes advanced by the minority were shifted upon the rest of the people. To some extent this would happen, but even then the resources of the many would not be subjected to anything like their normal tax bearing capacity. It is, of course, theoretically possible to impose direct taxes upon even the poorest, but the expense of tax-collection would thereby be so enormously increased as to make the attempt unjustifiable from a purely fiscal standpoint. "It is one of the open secrets of finance" that indirect taxes "have a knack for levying on the small resources of insignificant persons which direct taxes have never learned. They know how to coax pennies out of poor people whose names have never been on the tax-collector's books. But they are very sly and have at command a thousand successful dis-

guises. High or complicated tariffs afford them their most frequent and abundant opportunities. Most people have very short thoughts, which do not extend beyond the immediate phenomena of direct vision, and so do not recognize the hand of the government in the high prices charged them in the shops. Few of us taste the tariff in our sugar, and I suppose that even very thoughtful topers do not perceive the license tax in their whiskey."[1] This, then, is the first reason that both kinds of taxes are employed, namely, to reach taxable ability wherever found.

As the national wealth grows, the yield from taxes will normally increase, and thus in a way keep pace with the expanding needs of the government. In this tendency to increase there are some important differences between direct and indirect taxes. The automatic growth of indirect taxes is the more rapid in ordinary times, and their shrinkage is likewise more violent in periods of disaster and crisis. The reason for this is that the occasions of importation, manufacture, or purchase which give rise to revenue from indirect taxation multiply rapidly in times of prosperity, and decrease in hard times even more markedly. This results in a rapid and an automatic growth in the yield from indirect taxes in the first period, and in a marked diminution of such receipts when, on the contrary, production, importation, and sales fall off in number and amount. Direct taxes, on the other hand, imply some estimate of the property or income of the taxpayer. Such estimates cannot be rapidly adjusted to changes in the taxpayer's economic status. Estimates of income may be made each year, it is true, but re-valuations of property take place much less often. The result is that unless the rate of taxation be raised, the increase in the yield from

[1] Woodrow Wilson, Congressional Government, p. 132.

direct taxes is much more tardy than when changed industrial conditions spontaneously enlarge the volume of indirect taxes and reflect themselves in augmented revenues. On the other hand, if the growth of direct taxes is less rapid, it is steadier and less subject to shrinkage in times of need.[1]

There is one further consideration worthy of note in this comparison. That is the relative cost of collecting the two kinds of taxes. This refers, of course, only to the expense which the government is at in the process of collection. It does not take account of the attendant losses inflicted upon the taxpayer. Here the advantage lies generally upon the side of direct taxes. The average cost of collecting taxes runs between two and five per cent. of their total yield. Taking a broad survey of the question, the average cost of collecting indirect taxes approaches the upper limit; the cost of collecting direct taxes lies in the vicinity of the lower limit.[2] From the standpoint of financial productiveness we may then con-

[1] Good examples of these tendencies are cited by Leroy-Beaulieu, Science des Finances, I., p. 229 *sq.* Thus in England, under substantially similar conditions at the two different periods,

The income tax (direct) yielded between 1865 and 1879 an increase of 14%.

The spirit tax (indirect) yielded between 1865 and 1879 an increase of 24%.

The tendency of indirect taxes to shrivel in times of depression is much more serious than Leroy-Beaulieu represents it. Thus in the United States customs duties in the fiscal year '92-3 yielded $203,355,016; in '93-4, $132,818,530. Internal revenue in the fiscal year '92-3, yielded $161,027,623; in '93-4, $147,111,232.

[2] For details see Leroy-Beaulieu, Science des Finances, I., 270 *sq.;* Ely, Taxation in American States and Cities, p. 90 *sq.;* Bastable, Public Finance, p. 104. An exact statistical comparison of the respective costs of collection is very difficult. The mutually dependent relations of the various administrative bureaus, and the apparent variations in the rate of cost when the total receipts rise or fall below normal complicate the problem enormously.

clude that both direct and indirect taxes are necessary to reach taxable capacity in full measure: both are instrumental in providing for the growing wants of the state, their action in this respect being compensatory to a certain degree in that indirect taxes have the greater rapidity, and direct taxes the greater stability of growth. And, lastly, it is worth our notice that direct taxes are ordinarily somewhat cheaper to collect.

Industrial Effects. — Taxation provides the public treasury with the needed funds. This is its primary function. But no tax system can be judged solely by its capability to furnish the requisite revenue. A second question must always be asked, namely, how the tax system affects the national income, the ultimate source of all taxes. It is possible in finance, as the history of the later Roman Empire shows, to kill the goose that lays the golden egg. In one sense all taxes have the same immediate effect, to wit, the appropriation of a part of the national income for public purposes. Exorbitantly high taxes may even lessen the sources whence the national income flows.[1] But while both direct taxes and indirect taxes produce this effect of reducing the amount of wealth individually disposable, indirect taxes not infrequently produce ulterior effects upon the industry of a nation. These ulterior effects result largely from the manner in which indirect taxes are levied. In general the effective administration of a system of indirect taxes necessitates certain restrictions upon the ordinary freedom of industrial enterprise. For example, a customs system compels a government to limit the number of ports of entry. Thus importations are frequently made, not at the place most convenient for buyer and seller, but at the nearest available customs office. This is per-

[1] See page 14.

haps not a very serious restriction upon commercial freedom, as the custom-houses are located at all the great natural ports. It is an impediment, nevertheless, to economic transportation. Again, the indirect taxes which the federal government levies on tobacco and spirits necessitate in those industries a large amount of inspection, espionage, registration, enforced book-keeping, and the like, which, if universalized, would be found to be intolerably oppressive. And while it would be absurd exclusively to attribute the tendency toward concentration in certain industries, to indirect taxation levied on their products, still the facilities offered to large dealers, perhaps mainly in the interest of economical fiscal administration, by this system of indirect taxation, go to create monopolies or to intrench them more strongly when once they have come into existence.[1] The indirect cost of indirect taxes is many times greater than their immediate cost of collection. To what extent this is true of various kinds of indirect taxes we shall attempt to show later on. In general it is true that indirect taxes have an ulterior evil effect, restricting industrial enterprise, hampering trade, and thus obstructing in part the natural growth of the national income.

Effects upon the Distribution of the Tax Burden.— It is not sufficient that taxes be adequate to the needs of the govenrment; they ought also in the widest sense of the term to be as little onerous as may be to the taxpayers. Hence they ought generally to be apportioned according to the abilities of the taxpayers. How do direct and indirect taxes respectively stand this test of fairness or equity? For indirect taxes no substantial claim can be made on this score. Experience has

[1] See Ely, Taxation in American States and Cities, p. 83 *sq.*; Cliffe Leslie, Cobden Club Essays, second series, p. 189 *sq.*

demonstrated pretty conclusively that the great revenue-yielding objects are not articles of luxury or convenience, but are mainly the so-called necessities, staples of practically universal use or consumption, like wool, sugar, tea, woven goods, and tobacco. There are great difficulties in making any very considerable discrimination between the different grades of these staples so as to impose heavier taxes on the choicer and more expensive kinds. Thus it comes about that when the taxes on such articles have become a normal part of their expenses of production, the consumer bears the tax.[1] No one pretends that a tax on sugar, for example, stands in any proportion to the respective ability of the various consumers of sugar. A family with an income of $5000 does not consume ten times as much sugar as a family with an income of $500. Hence the smaller the ability to pay taxes, the greater is the weight of taxation imposed by such an indirect tax.

Direct taxes, when tried by this test of equity, are not found wanting to an equal degree, though they by no means deserve the indiscriminate commendation so often accorded them. By themselves direct taxes cannot be said to "realize justice." In the first place they are not universal; they are levied ordinarily upon only a small part of any community. In the second place, they are frequently shifted, in whole or in part, from the nominal payer to the actual user of the property taxed. On the other hand, it must be admitted that direct taxes do more nearly approximate the ideal of fiscal justice than do indirect taxes. They are proportioned to what is supposed to be the taxpayer's ability. And such apportionments are, roughly speaking, fairly accurate. Moreover, direct taxes are not shifted to any such degree as

[1] See page 72.

are indirect taxes. Some direct taxes are practically unshiftable.[1] To this extent they are, when viewed alone, more equitable than indirect taxes. The gross injustice of a system based wholly or mainly on indirect taxes is considerably tempered by the addition of direct taxes, especially if these be unshiftable. But the realization of anything beyond a rough kind of equity is generally beyond the power of the practical financier.

Political Effects.—The last test to which these two kinds of taxes must be subjected is the political test. Which is the more efficient in educating the citizen to understand and to perform his duties as a citizen? Which is the better calculated to maintain the stability and unity of the body politic? Here as elsewhere the political doctors disagree. "If all taxes were direct," says John Stuart Mill,[2] "taxation would be much more perceived than at present; and there would be a security, which now there is not, for economy in the public expenditure." This seems very probable,[3] although where direct taxes are in vogue there is often wasteful and extravagant expenditure, as, for example, in our municipal governments at present. Even here the most corrupt of city governments, as the Tammany régime in New York City shows, have appreciated the necessity of a low tax rate to keep themselves in power. So that Mill's contention still carries weight. On the other hand, it is alleged with some show of reason that a·

[1] See page 77.

[2] Principles of Political Economy, Bk. V., Ch. VI., § 1.

[3] Leroy-Beaulieu's attempt to minimize the importance of this fact (Science des Finances, I., p. 252) by citing the case of the heavy income tax in England during the Crimean war seems to me very weak. The direct taxes were increased to keep pace with increased expenditure already necessitated by the war. To argue that they did not pacify the war spirit is not at all in point.

system composed entirely of direct taxes would lead to the repudiation of public debts. Our commonwealths have done this in more than one instance.[1] It is certainly a grave comment upon existing methods of taxation that there is danger in letting the people understand how great taxes really are, for fear the people may smash a part of our ordinary financial machinery. A resort to an exclusively direct system of taxation might lead to greater future economy in expenditure, and at the same time occasion the repudiation of engagements already contracted. To the administrator the unquestionable advantage attaching to indirect taxes is their popularity. The maintenance of the *status quo* may be at times of far vaster importance than rigid governmental economy or the promotion of a more widespread interest in politics. While it is difficult to forecast social tendencies, the opinion might perhaps be reasonably hazarded that, while anything like the remission of most existing indirect taxes is very improbable, 'democratic finance' seems to be moving in the direction of increased direct taxation. Income taxes are the product of the nineteenth century, and the large taxation of inheritances points in the same direction.

General Conclusions as to the Construction of a Tax System.—The complex nature of the problem of constructing or reconstructing a tax system even in part will be evident when one bears in mind the many conflicting advantages and disadvantages of direct and indirect taxes. Besides the vague general principle that both are necessary in present conditions, no general rule can be laid down. At various times different considerations are uppermost. When revenue is urgently needed

[1] Cf. W. A. Scott, Repudiation of State Debts in the United States.

the collateral evil effects of indirect taxes must often be endured. When revenues are abundant and public needs less pressing, scope is afforded for securing greater equity in taxation, enlarged freedom in industrial undertakings, and increased interest in good government. The application of the general principles to concrete situations must be determined by the practical financier.

Direct and Indirect Taxes in the United States.—The federal government derives by far the greater part of its income from indirect taxes. The main sources of this revenue are (1) customs duties levied upon imports, (2) excises or internal revenue taxes levied mainly upon the production of spirits and tobacco, and (3) postal receipts. The last we shall treat under the head of income derived from the performance of services by the state. The tax upon the national banks is almost the only direct tax imposed by the federal government. This is of minor importance.[1]

The commonwealths and the local governments, on the other hand, derive almost all of their revenue from direct taxes. Of these the (1) general property tax and (2) corporation taxes are the most important. Inheritance taxes are collected by some of the commonwealths. The causes for this assignment of direct taxes to the one and indirect taxes to the other are partly legal and partly economic. The Constitution of the United States (Art. I, Sec. 10) excludes the states from raising revenue by means of customs duties. The federal government itself is prohibited from taxing ex-

[1] The recent taxes imposed by the Act of June 13, 1898, to raise money for the Spanish war are not covered in this description. So long as their permanence is doubtful, it seems best to omit them from consideration here. See Appendix A.

ports. There is, however, no direct legal restriction to forbid the states from resorting to internal revenue taxes upon articles manufactured within their jurisdiction. To do this, however, would result in driving these industries to other states where no such taxes were imposed, or where, if imposed, they were less severe. Nor can a state effectually resort to taxation upon such articles manufactured elsewhere, but brought for consumption within their own jurisdiction. Such attempts would probably be adjudged interference with interstate commerce, whose control is jealously guarded by the federal government (U. S. Cons., Art. I, Sec. 8). Thus the states and the local governments are practically restricted to direct taxes. On the other hand, while the federal government has the power of collecting direct taxes, such taxation must be territorially uniform throughout the land (U. S. Cons., Art. I, Sec. 8); and must also be apportioned among the states "according to their respective numbers" (U. S. Cons., Art. I, Sec. 2). As this second provision would so grossly violate all considerations of an equitable distribution of taxation, inasmuch as the aggregate wealth of the older sections is largely in excess of their numerical proportion of the total population, the federal government is practically restricted to indirect taxes.

The next part of this work will be devoted to the consideration of taxation in the concrete, beginning with Direct Taxes, mainly collected by the states and local governments, especially the general property tax and corporation taxes. Thereafter indirect taxes, mainly collected by the federal government, particularly customs and the internal revenue, will be reviewed. Lastly, we shall glance at the subject of income taxation (direct), practically unused at present by either federal or state governments.

CHAPTER V.

STATE TAXATION (MAINLY DIRECT).

History of the General Property Tax.—The federal government, as explained in the last chapter, has pre-empted the domain of indirect taxation. This result is due partly to the constitutional inhibition laid upon the commonwealths forbidding them to impose duties on imports, partly to the economic necessity under which the commonwealths labor of abstaining from taxing any productive enterprise "that could or would run away"[1] to another jurisdiction which might deal with it more considerately. The consequence is that our state and local governments are forced to raise nearly all of their revenue by direct taxes.

By far the greater part of this revenue is derived from the general property tax. This tax, or, more properly, this tax system, consists in raising revenue upon a valuation of substantially all property within reach of the taxing power. The rate of taxation is ordinarily[2] uniform, irrespective of the different kinds of property taxed and without regard to the ownership[3] thereof. Notwith-

[1] "Never tax anything that would be of value to the state, that could or would run away, or that could or would come to you." This canon of taxation is contained in a pamphlet entitled "The Tax Question" (1873) by Mr. Enoch Ensley.

[2] In some states personal property is taxed at a lower rate than real estate.

[3] Frequently the property of ecclesiastical, charitable, and educational institutions is exempt from taxation; the property of the state and of the United States always.

standing the endless variety in the details of the tax systems of the various states, the underlying theory of taxation embodied in the general property tax [1] is everywhere unmistakably the same. The system assumes that the payment of taxes is the duty of every property owner, that the value of the owner's total property is the index of his ability to contribute to the public treasury, and that this measure of ability can with measurable accuracy be ascertained—three propositions of which the last two contain far less than the whole truth.

The universal prevalence of this system warrants a word of explanation with regard to its history. In early colonial days taxes were light and frequently irregular in occurrence. The general treasurer of Rhode Island in 1649 reported that "he had received nothing and had nothing in his hands." [2] The town clerk of Providence wrote to Sir Henry Vane: "Sir, we have not known what an excise means. We have almost forgotten what tythes are; yea, or taxes, either to church or commonwealth." The expenses of the colonial governments were frequently met by the sale of public lands, or by their rentals, by the fines and fees exacted in the courts, and not infrequently by having recourse to such questionable shifts as public lotteries or to

[1] The name of a tax, it must always be borne in mind, refers to the basis of its exaction, and does not connote a discrete source of income or fund of property. All taxes take the property of individuals. This is, in the last resort, the only source of taxation. But the general property tax levies on the taxpayer upon the basis of the capital value of his total property; the income tax, upon the basis of his current income; indirect taxes, upon his purchases of particular commodities. The different taxes may be compared to different faucets to the same tank. They may all draw upon the reservoir at the same time. For a good explanation of the relation of capital and income see Hadley, Economics, p. 464.

[2] Ely, Taxation in American States and Cities, p. 108.

such unquestionable frauds as issues of fiat money. Oliver Wolcott, Secretary of the Treasury, made a report to Congress in 1796 of the tax methods then in vogue in the various states. In this document it appears that some of the states had already adopted the general property tax.[1] The majority, however, enumerated certain specific objects[2] of taxation, such as land, slaves, and polls; and assessed these objects not at their value in money, but at an arbitrary valuation which listed all land of the same grade at so much an acre, slaves at so much a head, and so forth. The transition to a tax based upon the total value of property as an undifferentiated whole was inevitable. For wealth grew apace. New forms of property multiplied. Town lots became more valuable than equal areas of grazing land. The ingenuity of the legislator was tortured to keep the swollen legal list of taxable objects abreast of the constantly growing complex which comprised the community's wealth. Every new kind of chattel slipped through the meshes of the legal net until, in one state after another, the unequal contest ended in the adoption of an omnibus clause. Instead of naming specific taxable objects and by implication exempting all other objects, the new system specified the exemptions, if any, and taxed everything else. This change, necessary as it proved, was not the outcome of diversified kinds of property solely, but was due as well

[1] "Taxes are imposed on the mass of property, real and personal, with certain exceptions, in the states of Rhode Island, New York, Delaware, and Maryland." Wolcott's Report. Annals of Congress, 1796-1797, p. 2700.

[2] It is perhaps questionable whether there was at first any very radical difference in the basis of tax apportionment in the various states. The kinds of property were so few in number and so comparatively uniform in value that a few categories of taxable objects practically coincided with the sum total of property.

to the growing complexity of ownership in much of the property of these expanding communities. The economic complexion of our early colonial settlements was extremely simple. They were largely agricultural communities in which land was plentiful and to be had for the tilling. We should be inclined to smile at the scanty inventory of chattels possessed by the ordinary colonial households, but what they had was their own. They had to work hard for a bare subsistence, but they were not, at least at the beginning, paying interest on mortgages. Soon certain handicrafts arose, and later still manufactures under the factory system sprang up, especially in thriving towns and cities. Not only did wealth increase in amount and in kinds, but much of it was employed by those who had borrowed it. The 'loan fund' of available capital which the owners were willing to lend out at interest began to assume considerable dimensions. Where a borrower, therefore, deducted from the value of his property the amount which he owed, it was thought that the lender, whose equity was in the form of a note, mortgage, book-account, or bill of exchange, would escape taxation unless all property evidenced by credit paper were included among taxable objects. So it came about that all property, personal or real, was made subject to taxation, and ordinarily at the same uniform rate.

This process of transforming the elementary tax system into the general property tax may be best traced in some of our central states where the transition was rapid and comparatively recent. In the state of Ohio[1] land was originally classed in three grades, and every hundred acres of the same grade was taxed at the same rate.

[1] Ely, Taxation in American States and Cities, p. 135; also p. 146 *sq.*

Taxes for local purposes came from this tax on land combined with a poll-tax and taxes on specified farm chattels, each at an arbitrary valuation.[1] The tax laws of 1825 and 1831 mark the futile attempt to enumerate the new kinds of wealth which had begun to appear. Farm land was differentiated from town lots. The capital of merchants and brokers, "money at interest, all grist and saw mills, all manufactures of iron, glass, paper, clocks, and nails, all distilleries, breweries, tanneries, all iron, brass, and copper foundries," were expressly included. When the state constitution was revised in 1851 this procedure of encyclopedic enumeration was given up, and what was practically an omnibus clause[2] was inserted—a clause so uncompromisingly rigid as to specifically include the bonds of the state[3] and of its local governments among taxable objects. *Ex uno disce omnes.* By the end of the civil war the general property tax had become practically universal in our commonwealths.

Administration of the General Property Tax. — The first step in the administration of this tax consists in listing the community's property. Here the legal distinction between real estate and personal estate furnishes a rough basis for the primary subdivision of the aggregate of the community's taxable wealth. Real estate ordinarily includes land with its fixed improvements, such as buildings. In computing the value of real

[1] All horses, for example, at $50 a head.

[2] General property tax laws at present frequently enumerate specific kinds of property which are to be listed for taxation, but they make no attempt to enumerate the various industries whose property is to be taxed.

[3] Governments frequently exempt their own bonds from taxation, and thus secure a higher purchase-price for them than otherwise could be obtained. The higher price makes good the loss of future taxes on the bonds.

estate, however, deductions are not generally made for mortgage indebtedness resting thereon. Thus a house worth $20,000, but mortgaged for $5000, might stand assessed jointly with the mortgage at $25,000.[1] Personal estate includes all property not classed as realty. Thus chattels such as live stock, raw materials, machinery, and furniture are examples of personal estate. Property the legal title to which is evidenced by credit paper is also classed as personalty. It is worthy of notice that the economic corpus of real and personal property is frequently identical. It is therefore a mistake to confound the legal title of property with its economic corpus or material embodiment. Strictly speaking, a mortgage is not property, but the legal title to a part of the property on the basis of which the mortgage was issued. The same is true of notes, bonds, stocks, and bills of exchange.[2]

The primary listing and valuation of real estate is ordinarily intrusted to assessors, whose operations are confined to the smaller political subdivisions, such as townships or city districts. These assessors are generally under the control or supervision of a board of officials whose jurisdiction embraces the city or county. The valuations of real estate in the smaller areas are thus subject to review and correction, so that the basis of estimate is made approximately the same for the larger area. Within that area (ordinarily the county) the valuations of realty are relatively fair. Opportunity is normally afforded to any one who may feel aggrieved at

[1] In Massachusetts, Connecticut, New Jersey and Colorado mortgage debts are not taxed when the real estate has been assessed without deductions for such debts.

[2] Even government bonds are substantially nothing more or less than a title to a part of the productive property of the state that issues them, and also a lien upon a part of the future product of the state's citizens.

the valuation attached to his property to appear and state his case. Relief may be afforded where a clear case of unjust valuation is made out by the complainant. When the various counties of the state have completed their respective tax lists, these lists are frequently subject to review by a State Board of Equalization. The object of this tribunal is to make such an equitable adjustment between the county valuations as the supervisory county or city board has made between their respective townships or city districts. The personal knowledge of local conditions which makes possible an equitable readjustment of valuations within a city or a county renders similar work on the part of the state board practically impossible. Thus, while within cities or counties the valuations of real estate are relatively fair, as between the various counties of the state (or as between the various townships or towns when there is no county board of equalization), these valuations are flagrantly unjust. In one section real estate is returned at its market value, in another at twenty-five per cent. thereof. It thus happens that one section may pay towards state purposes twice or three times as much as its equitable share. These valuations of real estate are ordinarily revised and corrected only after intervals of some considerable duration, sometimes but once every decade. Thus, although a relatively fair estimate of realty is originally embodied in the assessor's list, its fairness is likely to undergo material alteration before the next revision, some property rising and some falling in value in the interim.[1]

The attempt is generally made to secure a complete

[1] In New Jersey the primary assessment of real estate is made frequently by the owner, and its value is annually stated upon the tax return. Thus a yearly valuation of real estate is effected, though at the risk of under-estimate in the first instance.

list of personal property by requiring the owners thereof to make out an inventory of their personal estate and to affix thereto its true value. This "disclosure," as it is humorously called, is generally supported upon oath or affirmation. The law which determines the place at which property of various kinds shall be taxed varies from state to state, the general rule being that realty is taxable where it is situate, and personalty at the residence of the owner.[1] In this self-assessment of personalty opportunity is afforded for deduction on account of debts owing by the taxpayer. It is perhaps needless to say that this deduction is made with unfailing scrupulousness, even for fictitious debts that have been specially—often fraudulently—contracted to serve this very purpose. In general, most personal property is not listed at all, and the value attached to that listed is often absurdly small. The same equalizing process already described with reference to real estate is frequently applied to the valuation of personalty. The aggregate valuation of real and personal property serves as the basis upon which taxes for both the commonwealth and the local governments are ordinarily based. The actual collection of these taxes is commonly intrusted to the officers of the smaller governmental units. The tax collected is sufficiently large to cover the expenses of the local unit as well as the local unit's share of the county and state taxes. Remittance is duly made to the county and state treasuries of the quotas apportioned to the township or city where the taxes have been actually collected.[2]

[1] See Cooley, The Law of Taxation, p. 369. Some states tax chattels, where they are found, and other personalty (credits) at the residence of the owner.

[2] This description of the general property tax must be understood to be a general description of the typical features of the

Defects of the General Property Tax.—The principles on which the general property tax is based are that property owners only should pay taxes; that the aggregate wealth of each owner is the fairest index of his taxpaying ability; and that this index can be approximately ascertained. The first two propositions are questionable; the third is almost always untrue. Accepting as we do the dictum that each should pay taxes according to his ability, we may justly question the assertion that the absence of property indicates total inability to contribute to the needs of the government. Is the salaried individual who has amassed no property, having saved nothing out of his entire income, unable to bear any share of the public burdens? It may be inadvisable on grounds of fiscal expense to attempt the collection of direct taxes from those who possess but a minimum of goods, but this procedure is dictated, not by considerations of equity, but on grounds of economical financial administration. That property is the fairest gauge of taxpaying ability is a canon whose truth depends upon the assumption that the individual's income will in the long run be proportioned to his realized wealth. This may be approximately true in the long run, but that there are numerous exceptions in individual cases is notorious. That a relatively fair disclosure of the total wealth of individuals is attainable is an assertion which the facts of financial history abundantly disprove. It is chiefly on this last ground that the tax on general prop-

system, but not equally applicable to every commonwealth. In some states the commonwealth collects the tax on personalty in whole or part and remits to the local governments their respective shares. In New Jersey the taxes for state purposes are raised mainly by the tax on corporations, and without recourse to a state tax on the aggregate of realty and personalty, except for education.

erty so frequently fails to secure the just distribution of the tax burden.

First, as between different communities. The unfairness in the basis of taxation for state purposes has already been explained.[1] As a partial mitigation of this inequality it may be urged that the tax levied for state purposes is commonly light. This is happily true, but it does not affect the principle involved. It might be supposed that the overtaxed sections would get some relief from the partial transfer of their property to the more lightly taxed sections, or that they would shift their taxes ultimately by a diminished rate of improvement upon their real estate. Individuals might thus get some relief. It is well known that the rate of taxation is ordinarily taken into account by those who are deciding upon the location of an industrial enterprise. But the actual fact is that the state tax is a variable quantity, now higher, now lower;[2] that it is imposed mainly upon real estate from which the tax burden is with difficulty shifted, and that the permanence of a low rate in any section is not assured. So that the probability is that the extra burden is borne at least for a considerable time by the overtaxed section, and that the readjustment through shifting processes is slow and generally incomplete.

More serious far than the unfairness between sections is that between individuals whose possessions are differently constituted of real and personal estate. As already indicated, the great mass of personal property is never taxed at all. It escapes through many devices. Omitting entirely the question of collusion[3] between the tax-

[1] See page 117.
[2] See Hadley, Economics, p. 459.
[3] I know personally of an estate which cost over a million

payers and the assessors, who 'for ways that are dark' are certainly 'peculiar,' personal estate dodges taxation by some of the following methods:

(a) The owner makes no return at all. Very generally the assessors first proceed to list real estate, and then require the return of personal property to be made by the owner of the realty. If the owner of personalty owns no real estate, his name is frequently omitted altogether from the tax list.

(b) Some personalty is purposely stricken from the tax list by the assessors. Stock in trade is often untouched by local assessors who fear to drive business to another place.

(c) Much personalty is never listed by the owners. Debts due from persons living at a distance are very infrequently disclosed. Stocks of non-resident corporations are seldom returned by the owner. Mortgages are not often uncovered by the mortgagee.

(d) Personal property is enormously undervalued. All doubts of the solvency or financial status of debtors are resolved by the taxpayer in his own favor.

(e) Vast deductions are made for fictitious debts. Frequently when taxes fall due there is an enormous nominal conversion of property into forms of wealth that are by law exempted from taxation.

The extent to which personal property escapes taxation may be estimated by comparing the amounts of realty and personalty returned for taxation with the true valuation thereof.

The last Census[1] shows that in 1890 the real estate in the United States returned for taxation was valued at

of dollars assessed at a valuation of less than one hundred thousand, while other property in the same section is generally assessed at over half of its market value.

[1] See Abstract of the Eleventh Census, p. 188 *sq.*

18,956 millions of dollars and the personal property at 6516 millions. The true valuation of real estate in 1890 the Census estimates at 39,544 millions, and of personal property at 25,492 millions. The older and wealthier a community is, the greater is the relative amount of its personal property. We should expect, therefore, to find in the larger cities personal property aggregating more than real estate. Just the reverse is the case. In New York City[1] in 1893 real estate was valued at 3626 millions of dollars, personal property at 411 millions. In Brooklyn in 1895 the personal property returned was only a trifle over one per cent. of the total valuation. In New Jersey in 1893 the total taxable valuation was 768 millions, of which realty comprised 651 millions.[2] Where the relative amount of personal property is greatest the amount disclosed for taxation is generally least. This is due in part to the fact that personal property in the form of farm chattels is readily discoverable, while personal property evidenced by credit paper is generally inaccessible to the collector. Nor is this tendency for personalty to escape taxation on the decrease. The tendency is strongly in the opposite direction. The most stringent laws have been repeatedly passed to effect the disclosure of personal estate, but in vain. The board of assessors of Boston is described by Mr. Thomas G. Shearman as being an honest and able body, "fanatical believers in the taxation of personal property," and "armed by law with almost despotic powers of valuation." In 1889 the whole amount of taxable personalty, exclusive of bank stock, which they could discover was $39,000,000. "Being dissatisfied with this estimate, which was all that was justified by any facts which they

[1] See Seligman, Essay in Taxation, p. 27 *sq.*
[2] Legislative Documents of N. J., 1893.

could state, they proceeded to multiply it four and a half times by a mere guess."[1] Some years ago there was passed in Ohio a law known as the tax inquisitor law, or more commonly as "the blackmail law." This empowered individuals who would disclose their neighbors' personal property on which taxes had been due but not paid, to collect the back taxes. A large part of the tax thus collected went to the informer. The result has been that some wealthy citizens changed their legal residences to other states.[2] Some states have sought to uncover personal property through the machinery of oaths, affidavits, and the like. The effectiveness of such laws is inconsiderable. If Jove laughs at lovers' vows, he probably guffaws at taxpayers' oaths. Even the Psalmist's hasty allegation of universal mendacity needs little qualification in this province of finance. Where the taxpayer's conscience is tender he finds (as one has put it) that virtue is perforce its own reward. This phase of the system is described in one tax report as "a tax upon ignorance and honesty"; and in another report we are told that "the payment of the tax on personalty is almost as voluntary and is considered in pretty much the same light as donations to the neighborhood church or Sunday-school."[3]

The most glaring unfairness occasioned by the general property tax is between the farmers as a class and city residents. The farmers pay taxes on a greater part of their personal property than do the urban taxpayers. Whether this is in part shifted is perhaps an open question, but the onus of shifting the burden is upon the agricultural sections, and it is highly probable that much

[1] Natural Taxation, p. 81.

[2] See Ohio Tax Inquisitor Law, by T. N. Carver: Economic Studies, Vol. III., No. 3.

[3] See Seligman, Essays on Taxation, p. 31 *sq.*

of the unfair burden is never shifted at all. A piece of unfairness sometimes involved in the general property tax is that those who hold their property unencumbered by mortgages pay taxes upon their entire property. Those whose property, on the contrary, is mortgaged sometimes pay taxes only on the unencumbered part of their estate; and if the mortgagee pays any tax at all upon the mortgage, he is probably more honest than most of his class. The result of the system is a premium on indebtedness and an incentive to dishonesty.

Transformation of the General Property Tax.—In the troubled waters of commonwealth finance there are two rocks of offence. Both are found in the operation of the general property tax. The first is the unfairness wrought by the taxation of realty for state purposes, the second is the injustice resulting from the futile attempt of local governments to tax personal estate. The former produces inequality in the tax burdens of different localities; the latter, inequality in the tax burdens of different classes of property holders.

The remedy for the first evil is not difficult to find. It is the abolition of the state tax on real estate. The basis of assessment upon which this tax is now imposed is unfair as between different sections. This basis of assessment is also incapable of any very material improvement through the machinery of state boards of equalization. If the temporary retention of real estate as a source of state taxation is necessary, as it may well be in the newer commonwealths where agriculture is almost synonymous with industry, an apportioned tax might be substituted for a rated tax. That is, instead of imposing a uniform rate of taxation upon the valuations now made of different sections, a state board or commission might approximately determine the respective

taxable ability of different sections of the state. Upon these sections in accordance with their taxable ability as thus ascertained a certain sum of money would be raised by the local collectors. In most of our states, however, the entire abolition of commonwealth taxation upon real estate seems feasible. The comparatively modest budgets of the commonwealths, as well as the torpid growth of these budgets, will permit the states to forego their revenues from this source. And conversely, the enormous aggregate expenditure of local governments, as well as its rapid expansion, seems to warrant the segregation of real estate for purposes of local taxation. The growing wants of local governments will thus have an adequate source of supply in the growing productiveness of real estate, especially within our larger cities and towns. Real estate is visible and tangible, and thus incapable of escaping the tax collector. Its fair valuation within local limits is perfectly practicable and is now approximately realized. Under the present system of the taxation of general property real estate pays an ever-increasing percentage of city taxes. The loss occasioned to local governments, therefore, by the relinquishment of local taxes on personal property would be readily recouped by a slight addition to the burden now imposed on real estate. Moreover, the collateral advantages of such an arrangement would largely recompense real estate owners for the small additional load on realty.

For purposes of fiscal adequacy it seems best in the taxation of real property to make no deduction for mortgage indebtedness, or indeed for indebtedness of any kind. A provision of this kind ought perhaps not to be imposed at once and without warning, for fear of prejudicing vested rights and of disappointing the anticipations of owners whose property has been mort-

gaged under the expectation of tax abatement for debts. It might safely be applied, however, to all future indebtedness, and to all debts whatever at the expiry of a stated term. No abatement for indebtedness will in the long run be no very substantial hardship to the debtor. The increase in the amount taxable will be offset by a lower rate of interest on his loans, while the greater amount of property thus brought under contribution (much of which would otherwise escape altogether) will tend to lessen his tax quota.[1] Such a refusal to deduct for debts in assessing property will also lessen the injustice of taxing those who are free from debt at a higher rate than those whose encumbrances are large.

Assuming that the commonwealth governments impose no taxes on real estate, it is inevitable that personal property should furnish the greater part of state revenues. The reasons for such a policy are weighty. Besides the gain in equity derived from relinquishing real estate to the local governments, the needs of the states can be adequately met by taxing personalty. The administrative apparatus, moreover, for reaching much personal property is possessed by the state governments alone. This latter fact accounts for the widespread adoption by our states of special machinery for taxing many corporations, such as railroads and banks. The extent and power of some of these corporations have grown to such a degree that they are but imperfectly amenable to the tax power of local governments. The

[1] Plehn, Taxation of Mortgages in California (Yale Review, May 1899,) demonstrates that the rate of interest on mortgages in that state has equalled the market rate of interest plus the tax plus the cost of shifting the tax. This has been the result under a law which taxed the owner on the value of property less the value of mortgage indebtedness thereon, and which taxed the mortgagee on the value of the debt. "The borrower is worse off than he would be if the mortgage were exempt, and the mortgagor

franchises under which they operate are ordinarily conferred by the state legislature. Hence it seems obvious that much personal property can be taxed adequately only by state officials. Prof. Seligman[1] affirms that "at present, especially in industrial communities, the greater part of the personalty in the hands of individuals consists of intangible personalty, mainly of corporate securities." The proposed plan, therefore, provides for the taxation not merely of a part but of the greater part of personal property. The complex questions involved in such special taxation are too many to be touched upon here.[2] In general it may be said that allowance is or ought to be made for the local taxes on real estate paid by the corporations or joint-stock companies whose personalty is taxed by the state. Moreover, the principle of 'stoppage at the source' ought everywhere to be adopted, if possible. This process is the deduction of taxes from dividends or profits at the time and place they are declared or paid, before they reach the owner's hands. Both on grounds of adequacy and of economy this procedure is highly advisable. The bases on which taxes are imposed on personal property are various. The stock and bonds of corporations ought both to be considered as the joint source of the earnings of the personal property taxed. Net earnings, including both dividends and interest on bonded indebtedness, constitute the fairest theoretical basis for imposing these taxes. But gross earnings on account of their certainty give perhaps a better practical basis. Should the tax raised by the state exceed its own needs, the remainder

were taxed upon the assessed value of the property without any deduction."

[1] Essays in Taxation, p. 136.

[2] For a full discussion of the matter see Seligman, Essays in Taxation, Chaps. VI, VII, VIII.

may be apportioned among the local governmental units.[1]

State taxation of personal property invested in corporations or in analogous stock companies, like express companies, leaves untouched the further question of the taxation of the remainder of personal property like farm stock or stock in trade. How is personalty in the shape of chattels to be brought under contribution as well as chattels evidenced by credits? Perhaps the best solution, as it is certainly the easiest, is to exempt such chattels from taxation altogether, on the assumption that processes of shifting will equalize the advantages attaching to different species of personal property.

Besides the taxation of personal property many of our commonwealths are deriving a substantial part of their revenue from taxing inheritances. Fifteen states tax collateral[2] inheritances; four states have passed laws taxing direct inheritances. The latter are ordinarily taxed at a lower rate than the former. Barring the irregularity in the yield of such taxes, for millionaire mortality is unpredictable, the tax is to be commended as furnishing ample returns, as being felt but slightly by

[1] The importance of state taxes on personalty may be instanced in the case of New Jersey. Here for the year ending Oct. 31, 1896, of the total net receipts amounting to $2,138,532, railroad and canal corporations paid $1,079,687 and miscellaneous corporations $707,951 additional. Seligman, Essays in Taxation, pp. 176, 177, gives statistics of the yield of state taxes on personal property, corporations, etc.

[2] Collateral inheritances are such as descend to distant relatives. The laws in the various states draw an arbitrary limit between direct and collateral inheritances. The latter are generally taxed at five per cent. of the total value. Sometimes the rate of taxation increases with the amount of the estate. The federal government imposed a war tax on inheritances by the law of June 13, 1898. The rate of taxation rises with the amount of the personal estate. See Max West, The Inheritance Tax, Columbia College Studies, Vol. IV., p. 175 *sq.* See also Appendix A.

the payer, and as justifiable on the ground of special state protection involved in the devolution of property. So long as the smaller direct inheritances are exempted, the law cannot be said appreciably to weaken the motives prompting to the acquisition of property. The yield[1] of the tax in 1894 was as follows:

New York	$1,688,954
Pennsylvania	869,179
Massachusetts	239,368
New Jersey	204,695

The probable form of state and local taxation in this country is already apparent. "State revenues will be derived almost exclusively from corporation taxes and inheritance taxes, while real estate will be relegated to the local divisions."[2]

[1] Seligman, Essays in Taxation, p. 134. I am inclined to dissent from Prof. Seligman's justification of inheritance taxes. He justifies them on the ground that they are fortuitous income which otherwise would not contribute to public needs. If the former owner has already paid taxes on his property, the taxation of his heirs is taxing the same property twice in the same year. Moreover, the fact that inheritances are fortuitous income to the inheritor does not increase the social income in the least.

[2] Seligman, Progressive Taxation in Theory and Practice, p. 215.

CHAPTER VI.

FEDERAL TAXATION (MAINLY INDIRECT).

THE INTERNAL REVENUE SYSTEM.

The Establishment of the Internal Revenue System.—The political acumen of the framers of our constitution is nowhere more cogently instanced than in the choice made of the sources of federal revenue by those we fondly canonize as "the Fathers." Their task consisted not only in wresting the grant of a strong central power for the new federal government from the reluctant forces of separatism, but in disguising the burden such a sovereignty, however beneficent, carried in its train. Hamilton's solution of the difficulty was a reliance chiefly upon indirect taxes—customs and excises—for the support of the new government. The system thus inaugurated is in its main outlines the system of to-day. "It may, therefore, be accounted one of the customary advantages which our federal government possesses over the governments of the states that it has almost always, in ordinary times, derived its entire revenue from prompt and facile indirect taxes, whilst the states have had to live upon the tardy and begrudged income derivable from a direct levy. Since we have had to support two governments it has been wisely resolved to let us, as long as possible, feel the weight of only one of them,—and that the one which can get at us most readily, and, at

the same time, be most easily and promptly controlled by our votes. It is a plain, convenient, and, on the whole, satisfactory division of domain, though the responsibility which it throws on state legislatures is more apt to pinch and prove vexatious than is that which it lays upon Congress." [1]

The origin of our federal system of finance is in some ways unique. It did not evolve as in England and on the continent out of a pre-existing jumble of 'ill-defined prerogative rights,' of market-fees, tolls, trade-licenses, and royal monopolies.[2] This system of taxing the manufacturer of certain products always implies a thoroughly developed system of exchange by means of which the producer may recoup his tax loss by increasing the price charged the purchaser. Such a system of transfers had not been developed throughout the length and breadth of the land in 1789. Produce was largely consumed by the family on whose farms it had been raised, and in many of the early agricultural communities barter was the dominant mode of exchange. Some five [3] of the states, it is true, had made the attempt to raise revenue by the taxation of domestic spirits. But it was evidently a half-hearted manœuvre, unpopular, costly, and soon abandoned.

As the revenue derived from customs duties proved inadequate to meet the expenses of the nascent government, Hamilton insisted with greater emphasis upon excise taxation. Congress with considerable reluctance acquiesced in his proposal, and early in 1791 [4] imposed

[1] Woodrow Wilson, Congressional Government, pp. 133, 134.
[2] Cf. Bastable, Public Finance, p. 470 *sq.*
[3] New Hampshire, Connecticut, New York, New Jersey, and Pennsylvania. Cf. F. C. Howe, Taxation in the U. S. under the Internal Revenue System, p. 16.
[4] Act of March 3, 1791.

a graduated tax ranging from nine to twenty-five cents per gallon upon spirits manufactured from home-grown materials. Perhaps no financial measure of the great Secretary was in its nature more of an experiment than this one. He was acquainted with the financial expedients of other governments. He knew that the 'drink duties' were relied upon in Great Britain for a large part of the national revenue, and he argued that such a scheme was practicable at home. Great was the opposition, however, which the law called forth. The rudimentary economic development of the newer agricultural communities, the sectional spirit which the law evoked, and the inefficient and often corrupt administration of the measure itself raised against it a storm of disapprobation. What was then the West was particularly bitter against the tax. Corn was their great staple product, and its cheap transportation was then possible only when the corn was condensed in bulk in the shape of spirits. In these regions "money was so scarce that barter was the prevailing means of exchange, and whiskey the recognized measure of value."[1] Notwithstanding abatements in the rates, and modifications of the law intended to placate these sections, the tide of opposition grew in strength until finally in 1794 the federal tax-collector was openly defied by the western counties of Pennsylvania, which rose in rebellion. The 'Whiskey Insurrection' was speedily quelled, and that, too, without great difficulty. But when to the disappointing returns of the tax we add the heavy cost of its collection—between fifteen and twenty per cent. of the total yield—and when we remember also the cost of suppressing the disorder,[2] we can hardly regard the excise on spirits

[1] F. C. Howe, *op. cit.*, p. 22.

[2] The cost of suppressing the rebellion was about $1,500,000

as a financial success. On the other hand, it must in fairness be said that it laid the foundation for what has ultimately proved an eminently practical financial system. It early asserted the power of the federal government, and thus proved a valuable object lesson to the unruly. Though supplemented by taxes on other articles such as tobacco and sugar, as well as by a direct tax, the system of internal taxation did not survive the downfall of the Federal party; and after Jefferson's election in 1800 the whole system was swept away, and for over a decade customs duties supplied the federal treasury with the revenue it required.

The financial difficulties of the United States during the second war with Great Britain illustrated two familiar truths. The first is that lenders of capital will no more readily lend to a government than to an individual unless they see the government making a manly effort at taxation to pay the interest accruing. The war of 1812 was undertaken under the mistaken idea that practically all the extraordinary expenses of the struggle could be met by borrowing rather than by extra taxation. By 1813 this was seen to be a delusion. The other fact which was exemplified was the familiar one that a party in power frequently adopts or is frequently driven to adopt means and measures which it may have execrated when in opposition. 'Necessity' is frequently the justification of the practical administrator, as well as 'the tyrant's plea.' Thus it happened that the dominant party, the Democrats, who had destroyed Hamilton's scheme of internal taxation, were led to create a similar system of their own. Under the guidance of Gallatin, Congress reimposed taxes upon the manufac-

at a time when the total income of the federal government was about $4,000,000.

ture of spirits as early as 1813.[1] Besides this impost, there were imposed at the same session of Congress stamp duties, an excise on sugar refining, and a direct tax upon the states. The stress of war seems to have precluded any insurrectionary expression of popular dissatisfaction which may have been felt at the rehabilitation of the former system of internal taxation. Repeated disasters in the field compelled Congress at the instigation of Secretary Dallas, the successor of Gallatin, to increase the rates of taxation, and to impose taxes upon additional manufactures. Products made from iron, paper, leather, and tobacco were heavily freighted with revenue charges, while the direct tax was doubled in amount. The cessation of the war early in 1815 reduced the government's expenditure, and while for two years longer the excise system continued in vogue, it was swept completely away in the closing days of 1817.[2] Thereafter for almost forty-five years the land had rest from the federal exciseman. Economy in public expenditures was the rule, and customs dues again became the main reliance of the federal treasury. Prudence probably would have dictated another policy. The retention of moderate duties upon certain eligible objects of taxation, such as spirits, would have proved but a slight burden upon the country, and would have preserved intact the necessary fiscal machinery which could quickly be run at higher speed whenever war became imminent. The best contrived tax systems, as experience demonstrates, require time to attain their normal efficiency. The creation of a capable administrative

[1] Acts of July 24 and Aug. 2, 1813.

[2] Taxes received after 1817 by virtue of the previous internal revenue legislation were those in arrears when the system was demolished by the Act of Dec. 17, 1817.

staff is not the work of a day, though when a nucleus of experienced officials exists, the extension of such a fiscal arm is speedily possible. The penalty of our hasty policy seemed, however, to put off the day of its coming; and not until we found ourselves in the throes of civil war, and the loan policy of Secretary Chase had miserably failed, were earnest efforts made to re-establish a federal system of internal taxation.

The Act of July 1, 1862, which re-created the internal revenue system was a sweeping measure.[1] "The one necessity of the situation," as Mr. Wells[2] puts it, "was revenue, and to obtain it speedily and in large amounts through taxation, the only principle recognized—if it can be called a principle—was akin to that recommended to the traditionary Irishman on his visit to Donnybrook Fair: 'Whenever you see a head, hit it.' Whenever you find an article, a product, a trade, a profession, or a source of income, tax it!" Successive acts enlarged the already swollen list of taxable objects, or raised the rates of taxation previously in force. Customs duties were increased at the same time, partly to secure additional revenue, and partly to shield from unequal foreign competition the domestic producer staggering under heavy excises. It was not, however, until 1866 that the efficiency of the internal revenue system reached its maximum. By that time the war had ended, and the more

[1] "To show the general scope of the law, it may be stated that it provided taxation upon trades and occupations; upon sales, gross receipts and dividends; upon incomes of individuals, firms and corporations; taxes upon specific articles not consumed in the use; stamp duties; taxes upon various classes of manufactures as well as taxation upon legacies, distributive shares and successions." W. Ford in Lalor's Encyclopedia, art. Internal Revenue.

[2] Godden Club Essays, second series, p. 479.

oppressive war taxes were being removed. Within three years after the cessation of hostilities the only remaining excises of any importance were those imposed on distilled spirits, fermented liquors, cigars, and tobacco. These articles have constituted the basis of the internal revenue system from that day to this. The retention of a federal system of excise taxation after the war was due to various causes. The vast debt contracted during the struggle demanded at first enormous sums to defray the annual interest charges. The Republican party, which was then in the ascendency, was the legatee of the excise policy of the Federalists. Lastly, certain manufacturing interests which had grown up under the stimulus of protective duties protested effectually against being exposed to foreign competition. So it happened that the internal revenue system, instead of being abolished as it had been in 1817, was simplified, and made a seemingly permanent part of our federal system of finance.

The Tax on Spirits. — The fewness of the articles upon which excise taxes until 1898 were imposed enables us succinctly to describe the internal revenue system by reviewing the respective imposts upon these products. For the fiscal year ending June 30, 1897, the aggregate receipts amounted to $146,619,508. Of this amount over eighty-two millions of dollars came from the tax on distilled spirits, while fermented liquors (mainly beer and ale) yielded thirty-two millions more. The tax on tobacco contributed almost thirty-one millions additional. Hence almost ninety-nine per cent.[1] of the internal revenue was until lately derived from the excises on drink and tobacco. We shall discuss these three taxes *seriatim*.

[1] The greater part of the remaining one per cent. came from the tax on oleomargarine.

Fully to appreciate the effect of the tax laid on distilled spirits it is necessary first of all to grasp the circumstances of the manufacture and use of such spirits prior to the Act of July 1, 1862. Maize or Indian corn was grown in such abundance that there was in almost every farming section a disposable surplus which readily found its way to the local still. The business of distillation was entirely free from anything like excise taxation, and instead of being localized at a few centres, was prosecuted everywhere. The product of the stills was used not only as a stimulant, but served in large measure as the raw material of many manufactures. The fabrication of burning fluid (a widely used illuminant, the predecessor of kerosene) absorbed annually some twenty-five million gallons of proof spirits. The preparation of dyes, varnishes, patent medicines, imitation wines and vinegar made additional inroads into the annual supply of alcohol,[1] so that of the estimated annual product of ninety million gallons, there was left only a part, though a good part, for individual consumption in the shape of 'ardent spirits.' Nevertheless the price of whiskey was uncommonly low, falling in August, 1861, in the Cincinnati market to thirteen cents a gallon, so that, as has been remarked, "previous to 1860 a man could undoubtedly get drunk in the United States with a less expenditure of money than in any part of the civilized world." [2]

Upon this Bacchic Arcadia the tax-gatherer 'came down like the wolf on the fold.' The Act of July 1, 1862, imposed upon distilled spirits a tax of 20 cents per proof gallon.[3] This was raised to 60 cents by the

[1] Cf. D. A. Wells, Practical Economics, p. 156 *sq.*
[2] *Op. cit. supra*, p. 163.
[3] A proof gallon consists of a mixture of equal parts of pure

Act of March 7, 1864, and to $1.50, and finally to $2 per gallon by the successive Acts of June 30, 1864, and Dec. 22, 1864.[1] Besides these taxes on the output, there were laid imposts on the processes of mixing and compounding spirits, and licenses were required as well for selling them at wholesale as at retail.

Under the combined influence of speculation resulting first from the varying fortunes of the federal arms, and second from radical and unstable tax legislation, all prices jumped up and down as though excited by a galvanic current. The price of distilled spirits and of alcohol, their chief ingredient, rose so high that its disuse in many of the arts was widespread and speedy. Petroleum luckily furnished a substitute for burning fluid, but in pharmacy the use of alcohol was curtailed about fifty per cent.

When no substitute for alcohol was to be had the price of the finished product reflected the increased cost of the raw material; and the effect of the higher price was to diminish the ordinary consumption. A decrease in the use of whiskey as a stimulant might have been viewed from one standpoint with complacency. But it was this very use of distilled spirits which most tenaciously held its own. Until the 60-cent rate was reached there was no perceptible decrease in the use of whiskey for drinking purposes.[2] Under the higher rates there was noticed a decreased use in the rural regions, where beer (the price of which had not been correspondingly enhanced) began to be consumed in greater amount. On

alcohol and water. The American standard gallon is the wine gallon, which contains 231 cubic inches.

[1] The two latter Acts taxed spirits distilled from grapes at a lower rate. Since 1868 spirits from whatever materials distilled have been taxed at the same rate.

[2] D. A. Wells, Practical Economics, p. 180.

the other hand, there was no noticeable diminution in the aggregate consumption in the larger cities where resort was had to the debasement of the quality of the liquor in order to keep the retail price from advancing. From a sumptuary aspect the net effect of the law had been to compel the people to drink practically the same amount of adulterated liquor rather than liquor of a better quality.

The effect of the tax upon the national revenues makes a somewhat more complicated story. In 1860 it was estimated that the annual output of distilled spirits in the United States was 90,000,000 gallons. This was before any tax was imposed. After the introduction of the internal revenue system the annual yield of the tax, the rate of taxation per gallon, and the number of gallons annually assessed for the first four years respectively are as follows:

Fiscal year ending June 30,	1863.	1864.	1865.	1866.
Total tax yield	$5,176,530	$30,329,149	$18,731,422	$33,268,171
Rate per gallon	20 cts.[a]	20 cts.[b]	$1.50[c]	$2.00
No. gallons returned (indicating total product).....	16,149,950	85,295,391	16,936,778	14,599,209

[a] In force for 10 months. [b] To March, 1864; thereafter 60 cts.
[c] To Jan. 1, 1865; thereafter $2.00.

This table requires some elucidation. It will be noticed, first, that the total amount returned for taxation, ostensibly indicating the total product, was always greatly below the estimated output of 90,000,000 gallons in 1860; secondly, that the annual product varied greatly from year to year, that for 1864 being apparently over five times as great as that for the year preceding; thirdly, that the relation between the rate of taxation and the total yield of taxation seems altogether indeterminate.

The explanation of these seeming discrepancies will shed light upon some of the most striking features of the tax on distilled spirits. The small product disclosed in 1862–3 is explained by the rawness of an inexperienced body of administrative officials. The immense increase in the amount returned the following year was due to the fact that the Act of March 7, 1864 (which raised the tax rate per gallon from 20 to 60 cents) did not apply to stocks on hand at that date.[1] The increase in the rate of taxation and the necessary rise in the selling price of all spirits produced after the higher tax rate was to be in force were both foreseen. The distillers consequently strained every nerve to augment their stocks before the advance in the tax rate became operative. Hence the enormous amount returned for taxation in the fiscal year 1863–4. The failure to make the higher tax rate retroactive put millions into the pockets of the distillers. At this point another element begins to enter into the problem. The subsequent advances in the tax rate to $1.50, and finally to $2 a gallon, were equivalent to a tax of almost 1000 per cent. upon the prime cost of manufacture. If the producer could evade the payment of the tax in whole or part, his profits were increased many fold. The abnormally high tax rate was equivalent to a premium on dishonesty. It was no longer 'prosperous to be just,' and most of the whiskey interest chose to be prosperous. By far the greater part of the whiskey produced for a time was never returned for taxation. Thus the annual output which paid tax in 1865–6 was less than fifteen million gallons, and in 1867–8 fell to less than seven million gallons. In this way it came about that the excessively high rates of

[1] Provided the 20-ct. tax per gallon had been paid or bond given for its payment.

taxation and the failure to make these rates apply to existing stocks promoted dishonesty and evasion on the part of the producers, fraud or connivance on the part of many revenue officials, venality and speculation in Congress, and leanness instead of plenty in the federal treasury. The reduction of the tax to 50 cents a gallon in 1868 greatly increased the revenue, removed much of the temptation to fraud, and aided to eradicate the taint of corruption which had almost completely permeated this entire branch of the revenue service.

The most convincing proof of the success, both moral and fiscal, of the abatement of the tax is seen in the fact that during the first four years during which the 50-cent rate prevailed the average revenue realized was $33,563,161, against an average annual revenue for the four years preceding (under the $1.50 and $2 rates) of $21,727,000. The average annual output indicated by these collections was over sixty-seven million gallons under the lower tax, and less than nine million gallons under the higher impost. The apparent difference in output indicates the enormous extent of the fraud perpetrated upon the government;[1]—a fraud at some times so palpable that the wholesale price of spirits would not cover the tax and the cost of manufacture combined.

The Act of July 20, 1868, which reduced the tax to 50 cents per gallon, imposed certain minor taxes graduated according to the capacity of stills and their annual output, so that the aggregate tax per gallon was about 65 cents. Besides the reduction of the tax rate the technique of collection was improved by the use of adhesive stamps to indicate the payment of spirit taxes.

[1] The history of the tax given by Mr. Wells has become an economic classic. Cf. Practical Economics, p. 216.

This at once made the general public an auxiliary revenue inspector, and served to identify spirits and to evidence their satisfaction of the tax requirements. But before long an agitation began seeking an increase in the tax rate to 70 cents per gallon. The animus of this proposal was veiled under the ostensible purpose of consolidating the existing major and minor taxes into a single equivalent tax on the product. Accordingly in 1872 a 70-cent tax per gallon was substituted for both taxes previously obtaining. Again in 1875[1] the rate was raised from 70 to 90 cents a gallon. This change exempted existing stocks as usual, thus giving the distilling interest and interested congressmen another sop. The revenue, however, kept fair pace with the tax, and the higher rates were perhaps as honestly collected as the 50-cent tax had been. There was still much corruption in the department of internal revenue, but the lower rate and the improved methods of inspection and collection prevented such wholesale fraud as reigned prior to 1868.

For almost twenty years the tax remained at 90 cents a gallon. The revenue from distilled spirits grew rapidly. The increased efficiency and honesty of the revenue service, and the change in the condition of whiskey manufacture, which was now centralized and localized, made the tax easy to collect. In 1894 Congress, following the advice of the Secretary of the Treasury, increased the rate to $1.10 per gallon.[2] This tax, moreover, was made applicable to stocks in bond.[3] Since

[1] These two Acts raising the tax per gallon are dated June 6, 1872, and March 3, 1875, respectively.

[2] Section 48 of the so-called Wilson Bill of 1894.

[3] It is gratifying to note that for the first time the change in the rate was made retroactive, and this, too, in spite of the alleged attempt of the Whiskey Trust to bribe Congress to exempt stocks on hand. Cf. Shearman, Natural Taxation, p. 17.

the passage of the Act there has been a noticeable fall in the revenue yielded by the tax on distilled spirits. The greater part of the loss has undoubtedly been caused by the widespread industrial depression and the consequent shrinkage in the use of spirits. But the increase in the tax, as well as the hard times themselves, renders the incentive to dishonest distillation greater than before, and discoveries of the illicit production of spirits have of late markedly multiplied.[1]

The excise imposed on fermented liquors, such as beer, ale, and porter, has contributed less material to the criminal literature of finance. The Act of July 1, 1862, imposed a uniform tax of a dollar a barrel.[2] The rate per barrel was lowered subsequently to 60 cents, but since April 1, 1864, the first rate was maintained until 1898, although a deduction of 7½ per cent. in the purchase of the revenue stamps used for this purpose made the tax really amount to but 92½ cents a barrel. This corresponds to an *ad valorem* tax of about twenty per cent., and was not high enough to incite to fraud. Owing to the surprising growth of the *per capita* consumption of malt liquors the yield from the tax upon fermented spirits steadily grew until it amounted to over thirty million dollars annually. The steadiness of the tax receipts from this source even in years of industrial depression, and the comparatively low *ad valorem* rate of taxation, indicated that in times of emergency this was one of our most promising financial resources.[3]

The Tax on Tobacco.—The third and last great con-

[1] "The average number of stills destroyed since the Act went into effect has approximated one hundred and fifty a month." E. C. Howe, Taxation in the United States under the Internal Revenue System, p. 202.

[2] Thirty-one gallons is the maximum capacity of a barrel according to the law.

[3] See Appendix A.

tributor to the internal revenue is tobacco. Upon the use of 'the weed,' whether by smoking or chewing, or in the form of 'the good old gentlemanly vice' of taking snuff, the federal government levies toll. The history of the excise on tobacco presents few features that have not already been commented upon in the case of spirits.[1] The tax on tobacco was originally imposed in 1862 under the pressing need of revenue. With the intention of increasing this revenue the rates of taxation were subsequently raised. As such advances in the rate did not apply to existing stocks, the rise in the selling price of the article was anticipated by the accumulation of enormous supplies far in excess of the normal demand. The enrichment of producers of tobacco would have been greater had not the deterioration of tobacco with the lapse of time set limits to the stock that could prudently be carried. The revenue from tobacco responded more quickly to the higher tax rates than had been the case with revenue from distilled spirits. Still fraud and evasion were rife, and the returns, though increasing in absolute amount, disappointed the expectations of the Treasury, until in 1868 the use of adhesive stamps and the substitution of specific for *ad valorem* duties brought substantially the whole tobacco product under contribution. Curiously enough the trend of subsequent legislation has been towards lowering the rates of taxation on tobacco instead of increasing them as in the case of distilled spirits. From 1883 to 1898 cigars were uniformly taxed at $3 a thousand;[2] and in 1890 the tax on smoking and manufactured tobacco was reduced to six cents a pound. The reason for this action was the existence

[1] Cf. Quarterly Journal of Economics, Vol. V.; art. on The Tobacco Tax by F. L. Omsted.

[2] Ordinary cigarettes were taxed fifty cents per M. See Appendix A.

of surplus revenue, and the unwillingness of protected interests to permit a reduction of protective duties. The unique features of the tobacco tax in the United States are its reliability and its capacity to yield additional revenue. Whether tobacco be classed as a luxury or as a necessity, it is an article whose consumption is exceedingly steady. "A tramp," says Mr. Smart,[1] "with 6*d*. in his pockets will spend 3*d*. on a bed in a lodging-house, a penny on bread, and 2*d*. on tobacco." This action is typical of the users of tobacco in the aggregate. While customs duties shrivel in times of depression,[2] the steady yield of the tobacco tax indicates how little the consumption of tobacco decreases in like circumstances. And when, as in 1883, the tax on tobacco was decreased almost one half, the notion that the use of tobacco would largely increase proved empty. The total consumption was but slightly affected.

Compared with other countries the tax levied by the United States on tobacco is extremely low, the *per capita* tax being but a third or a fourth of the *per capita* tax in Great Britain and France respectively; and the *ad valorem* rates on manufactured tobacco in this country being less than a tenth of the corresponding rates in Europe. Tobacco, like beer, seems to be capable of yielding millions of additional revenue at short notice.[3]

[1] Introduction to the Theory of Value, p. 23.

[2] As illustrative of this tendency we may cite the following:

Customs in	1872,	$216,000,000;	tobacco revenue,		$33,000,000
" "	1873,	188,000,000;	"	"	34,000,000
" "	1874,	163,000,000;	"	"	33,000,000

[3] The remaining articles taxed under the internal revenue laws prior to the Spanish war were oleomargarine, opium, and playing-cards. The tax on the first mentioned article yields over a million dollars annually. Its taxation is due to the outcry of the agricultural interest and is essentially a protective measure, contrived in the interest of butter producers and at the expense of the consumer.

The Canons of Excise Taxation.—An ideal tax system must so far as possible reconcile and harmonize a number of independent interests. The public treasury must be supplied with adequate revenue. This revenue ought to be exacted with the minimum interference with all that makes for a large national income. The apportionment of taxes ought to be equitable as between the contributors; and the political and moral sense of society ought in every practicable way to be guarded, or at least not outraged, by the state's financial system. In a previous chapter it has been indicated that a complete reconciliation of these different interests can be secured only approximately. Much less then can a single branch of a tax system be supposed to completely coordinate these divergent demands. Still in case of conflict, adequacy of revenue outranks the others, and the proper order of subordination has already been treated.[1]

Adequacy.—The study of the internal revenue system of the United States affords conclusive proof of Swift's dictum that "in the arithmetic of the customs two and two, instead of making four, make sometimes only one." [2] The highest rates on distilled spirits produced far less revenue than the moderate rates. There is no more certain fact than that *ceteris paribus* the consumption of an article will decrease if its selling price be advanced. There is a great difference in the degree according to which the use of various articles will be relinquished under the influence of a higher price which reflects the tax as an item in the increased expenses of its production. Only observation and experiment can determine what rates of taxation any traffic will bear. But

[1] See p. 92.

[2] Quoted in the Wealth of Nations, Bk. V., Ch. II,

too high or too low a rate is equally fatal if the fiscal quest is the maximum of revenue.

Experience has also demonstrated that in the selection of articles for excise taxation the great staple articles of popular consumption, comparatively few in number, must be chosen. Luxuries even when taxed at the heaviest rates yield, comparatively speaking, little revenue. But spirits, tobacco, tea, coffee, and sugar when taxed yield their millions and tens of millions. The difficulty of taxing articles of luxury is that such articles must be taxed on the basis of their value. If different rates are assessed on articles according to their value, the door is at once opened throughout entire schedules to wholesale undervaluation and fraud. These dangers make specific rates of duty preferable, even though the effect of such rates is to tax alike the high-grade and the low-grade article. It is better for the consumer of moderate means to pay a slightly higher percentage tax on the articles he uses than to be mulcted twice to make good evasions which too nice a regard for ideal justice have occasioned.

Almost equally important with the proper choice of the rates and objects of excise taxation is the selection and training of a capable administrative staff of revenue officials. Mr. Howe does not overestimate the fundamental necessity of this requisite when he says: "Probably no branch of our national administration has suffered so much from the spoils system as has the internal revenue service; for in no department of the government are efficiency and honesty so essential in the employee."[1] No governmental department can at once attain its greatest efficiency under the spur of new de-

[1] Taxation in the United States under the Internal Revenue System, p. 195.

mands. Time is essential. But given a nucleus of trained financial specialists with certain tenure of office during good behavior, and a speedy adjustment to new conditions is assured. The cost of collection[1] of taxes depends largely upon the character of the Treasury's civil service. Even improved methods in the technique of collection are largely due to this source.

Viewed as a whole, the internal revenue system is the most satisfactory part of our entire financial structure, state or federal. Its returns are fairly steady and reliable in times of depression. Its growth is automatic. It is imposed on articles the demand for which is tolerably inelastic. Its burden is not perceptibly felt. It is honestly and economically collected; and, finally, it is abundantly capable of yielding additional revenue should an unforeseen emergency arise.

Effects on Industry.—The seamy side of excise taxation reveals itself in its interference with the development of industries which are subject to such taxation. Under our system this official oversight of private business is practically confined to such industries as distilling, brewing, and tobacco manufacturing. Fortunately no attempt is made to tax the raw material of these products while it is in the hands of the original producer,—the farmer. Such taxation would involve an intolerable extension of the revenue administration and an equally intolerable interference with agricultural operations at their inception. This is really the main objection to any excise tax on raw material—that it necessitates a widespread and vexatious cramping of industry at its birth. When once the raw material is in the hands of

[1] The cost of collection of the internal revenue is less than three per cent. of the total yield. It was about 2.70 in the fiscal year 1895-6.

distiller, brewer, or tobacco manufacturer, the watchful supervision of the revenue department begins. The producers are required to give bond for the faithful observance of the law. They are required to register all material bought and sold, together with whatever stock they keep on hand. A particular method of book-keeping and often monthly reports are exacted by the revenue officials, who also assume liberty to examine the books of the producer at any time. Such interference, if universal, would strangle industry in the tightening coils of red tape and officialism. Still, long continued usage has probably made this species of state interference tolerable.

In so far as the prices of these products are competitive prices, fixed by the marginal expenses of production, the cost involved in this governmental supervision is ultimately borne by the consumer. Nor must we neglect the possibility that these expenses of production are higher than they might otherwise be if the routine processes demanded for purposes of fiscal convenience had not paralyzed much inventiveness which else had trained its genius upon devising new and cheaper processes. It is often alleged that excises tend to favor the large producer at the expense of the small producer. The bond required previous to starting in business and the economies secured by production on a large scale are both seemingly favored by excise taxation. Some such influence may have been exerted by our internal revenue system. But the trend of production in manufacture has been towards production on a large scale, and distilling and tobacco manufacture have proved no exceptions to the general rule. Moreover, the prices of these products are by no means wholly competitive prices, so that it is not easy to determine how greatly, if at all, their

selling price has been indirectly affected by the interference caused by the revenue officials' supervision and inspection. Lastly, when we note that the *raison d'être* of production on a large scale is the decreased cost of production thereby effected, it is very doubtful whether old-fashioned and expensive processes have been kept in vogue even indirectly by our internal revenue system. The practical effect of this system has been to make the federal government the biggest partner, though a silent partner, in these industries, and to raise abundant revenue without inquisitorially encroaching upon the sphere of general industry.

Effects on Public Morality. — Excise taxation has been advocated frequently as likely to reform public morals or to abate public vices. The would-be reformer is apt to imagine that he has discovered 'a nice, easy, original plan of social salvation' in an impossibly exorbitant tax on intoxicating liquors. Unfortunately this is not the fact. Such a tax is unlikely to produce any permanent diminution in the quantity of liquor drunk.[1] It is almost certain to debase the quality of the liquor, and to engender enormous frauds by reason of dishonest attempts to evade the tax. Indeed about the only favorable moral influence that an excise can exert is the negative influence of not tempting taxpayers or tax-collectors above that they are able. It is a false and cynical axiom that every man has his price, but most persons' integrity is more or less elastic, and like the Yankee of the story,

[1] "....the whole evidence from the experience of the United States is, that if the great and rapid increase in the price of distilled spirits of the year 1863, through federal taxation, did for a time and to some extent operate to diminish their popular consumption, the effect was but temporary." D. A. Wells, Practical Economics, p. 183.

while they would refuse to "lie for a ninepence" (the New England eighth of a dollar), they "would tell eight of 'em for a dollar." Fiscal adequacy and the conservation of morals are both subserved by moderate rates of taxation.

The Burden of Internal Revenue Taxes. — The burden of the internal revenue tax would ultimately fall entirely upon the consumer if the prices charged for liquor and tobacco were purely competitive. In case these products were closely monopolized, a tax like our internal revenue would be borne in part by the producer and in part by the consumer.[1] But the fact is that liquor and tobacco, while in part monopoly products, are not so altogether. Even our most sweeping monopolies feel the force of residual competition. Hence the difficulty of locating with assurance the incidence of our internal revenue. It seems probable that the incidence is divided between producer and consumer, though the problem is a complex one.[2] The truth seems to be that retail prices of such articles as liquor and tobacco are fairly stable. When, therefore, the producer finds his profits shrink he throws the tax in part upon the consumer by debasing the quality of the product rather than by increasing its retail price. But this very resort to debasement implies a pressure upon these producers which they can thus shift in part without suffering materially from the competition of other producers who are in substantially the same position. The chances therefore are that the burden of our excises is distributed between

[1] Cf. the general treatment of the incidence in taxation in Ch. II.

[2] Cf. Howe, Taxation in the United States under the Internal Revenue System, pp. 165, 166, and 254 *sq.*, where the view is taken that the producer bears at least a part of the tax.

producer and consumer; and that the advantages and disadvantages which the consumer in the first instance experiences are largely those of a difference in the quality of the goods consumed rather than in variations in the retail price he pays.

CHAPTER VII.

CUSTOMS DUTIES.

The Two-fold Uses of Customs Duties. — The federal income, as was incidentally remarked in the preceding chapter, springs mainly from the taxes levied on certain domestic manufactures, and from duties imposed upon goods and merchandise brought within our customs frontier. It is the revenue which accrues from these latter that will next demand our attention. These customs receipts unfortunately do not readily lend themselves to a perfectly colorless and dispassionate scrutiny. Interlacing this part of the financial fabric are to be found strands of an industrial policy which has excited and which still excites endless controversy. In other words, the taxes which are imposed upon imported commodities are in the main designed either to raise money for the Treasury or to protect certain domestic industries, and between these two ends there is no 'pre-established harmony.' It would indeed be an unfair presentation of the case to assert that a tariff of duties whose primary aim is protection is incapable of raising, together with the internal revenue, sufficient money for the economical administration of the federal government. Such a statement of the case would be as misleading as the opposite contention that a revenue tariff is necessarily synonymous with a deficit But the position can hardly be assailed that a tariff which

was exclusively designed for purposes of raising revenue would be built on very different lines from a tariff whose primary aim was to afford to domestic industries a shelter from foreign competition. It is just here that the difficulty arises in treating customs duties from a financial standpoint exclusively. The financial interest and the industrial interest (assuming that the latter is to be subserved by a protective policy) are, if not hopelessly divergent, at least in the first instance, by no means in complete accord; and whether the public is benefited the more by making one interest subservient to the other, or by striking a rough compromise between the two, is a question of practical policy which cannot be decided on financial grounds alone. Upon the issue of protection itself it is hardly safe to assume that there will be any general agreement for many years to come. But there is little ground for debate upon the lesser issue that there is no necessary connection between the revenue yielded by a tariff which accords the desired degree of protection, and the revenue which a tariff is capable of yielding if constructed exclusively with reference to revenue. The protectionist may logically concede the fact and yet contend either that the hampering of the fiscal machine is of relatively little moment, or, even if great in itself, is more than offset by 'the far more exceeding and eternal weight' of gain which the policy of protection brings in its wake. On the other hand, it is true that to one who is not convinced of the utility of the protective policy this crippling of the arm of the fisc is an additional grievance which he lays up against the protective system. But that is a matter which we need not pursue here. What is much more to our present purpose is to point out that, waiving the question of protection, whose discus-

sion here would take us too far afield, it will be necessary to consider first those general aspects of customs duties which are common alike to protective and to revenue tariffs, and then to give separate consideration to a tariff system built consistently upon revenue principles only. But before essaying this task of establishing the principles on which tariff duties ought to be based, it will be convenient to sketch in brief outline the checkered course of our national tariff policy.

The Tariff Policy of the United States.—It is a matter of some curious interest to compare the antiquity of customs duties with the modernness of excises. The latter require naturally enough a developed system of production and exchange, and would obviously be impracticable under a régime of household industry or a 'natural economy.' Customs duties, on the other hand, are almost as old as the common law. Their exact origin in England is unknown, but "the reason for their existence is clear.[1] The merchant in those predatory times, when every one was so ready and eager to fleece him that '*pillé comme un marchand*' became subsequently a proverb, willingly paid on entering the kingdom and on taking merchandise out of it toll to the king for the necessary safeguard for himself and his merchandise, *ineundo, morando, et redeundo*,[2] in port, on land, and on the seas. The toll was, in short, in the nature of a premium paid to the king for insurance. But in whatever manner these tolls may have commenced in England, they became subsequently definite in amount, acquired by continuance the validity allowed to that which has long existed, and so came to be termed '*consuetu-*

[1] S. Dowell, A History of Taxation and Taxes in England, Vol. I., p. 75.

[2] Quoted from paragraph 41 of Magna Charta.

dines,' or customs." In the course of their development the rates of customs duties became flexible, and their figures were fixed from time to time by parliamentary statutes. During the period of the settlement of the English colonies in America the customs machinery of England was employed with a protective purpose to build up various industries in England. Still this policy of monopoly which was dictated by the dominant mercantile system did not greatly vex the colonists at first. Cromwell's Navigation Act of 1651 left them to trade with whom they would, but restricted such commerce to the vessels of English subjects. Still this law was honored perhaps as much in the breach as in the observance, inasmuch as the Dutch continued thereafter a contraband trade with the colonies. Even when to the monopoly of navigation there was added later the monopoly of trade, and when trammels were put on intercolonial commerce and upon colonial manufactures, the yoke did not for a long time appreciably gall the colonies. Restrictions on foreign trade did not weigh heavily on the light-hearted smuggler; restraints on intercolonial commerce were frequently practised by the colonies against each other; and the strict prohibition against prosecuting certain manufactures in the colonies was not likely to create much discontent when their labor was so much more richly rewarded when applied to agriculture or commerce, that the colonies were themselves driven to various expedients (such as bounties and in some cases even to protective duties) to promote the hoped-for manufacturing industries.[1] The war of the Revolution was brought about not so much by the passage of new acts as by the rigid enforcement of existing statutes. The Stamp Act

[1] Cf. Rabbeno, American Commercial Policy, pp. 101, 102.

was, however, an additional grievance, and the growing discontent of the colonists naturally centered around the issue of taxation. During the struggle for independence each state practically adjusted its imposts and customs duties to suit itself. There were certain shadowy restrictions in the Articles of Confederation upon the exercise of such power by the individual states. But here as elsewhere the Confederation proved but a 'rope of sand,' and after the cessation of hostilities with the mother country some of the states engaged in a mutual war of retaliatory tariffs. Indeed the difficulties attendant upon this tariff struggle contributed effectively to the calling of the constitutional convention and to the framing of the present federal Constitution. That document lodged in the hands of Congress exclusive power[1] over the levying of import duties, and at the same time utterly forbade the imposition of duties on exports.[2] Throughout the Revolution, Congress and its Financier, Robert Morris, sought in vain to obtain from the states the necessary assent to a modest federal impost; but the plan failed both then and afterwards until the necessity of placing such power in the hands of the national government was formally recognized in the new charter.

Tariff legislation under the Constitution began with the Act of 1789, and the first distinct era in our tariff history may be said to extend from that date to 1808. The character of this patristic legislation has been portrayed by contending disputants in very different colors. Protectionists cite the protective aim avowed by the advocates of such legislation. They also cite the distinct

[1] U. S. Cons., Art. I, Sec. VIII, 1.

[2] U. S. Cons., Art. I, Sec. IX, 5. The probable reason for such action was to guard against possible injustice to any section. Thus a general tax on the export of cotton would have been collected only in the southern states.

statement of the protective purpose to be found in the preamble of the first act. On the other side it is pointed out that the general level of duties was but five per cent. *ad valorem*, and that the highest rates of duty on luxuries did not rise above fifteen per cent. The truth seems to be that the willingness of Congress to accord a modest degree of assistance to nascent American manufactures was rather the outcome of the spirit of nationality intent upon both political and economic independence than any very clearly reasoned scheme of industrial development. Hamilton, indeed, in his Report on Manufactures (December, 1791) put in classical form the protective creed, but it can hardly be doubted that Hamilton was largely influenced in his advocacy of protection by political considerations, especially by his desire to attach to the support of the new federal government the commercial and business classes. There was a gradual increase of tariff duties until the *ad valorem* rates in 1808 were from 15 to 22½ per cent. This increase has been variously interpreted. One side alleges that it shows steady and conscious growth of the principle of protection; their opponents maintain that almost every augmentation of rates was due to the growing needs of the Treasury. This much seems to be certain, that the amount of protection afforded by such moderate duties as were accorded up to 1808 could not have been very considerable, and that such duties did not have the effect of creating new manufacturing industries of any extent by diverting labor and capital from the fields of agriculture and commerce, where for the time being the expenditure of industrial energy was most liberally repaid.

The change in our industrial conditions began about 1808, and, instead of being the result of our conscious choice, was forced upon us from without. The struggle

which was pending between Napoleon and Great Britain involved us in difficulty on account of the restrictions placed by the contestants upon our commerce. The disregard of the rights of neutrals practised by France under the Berlin and Milan decrees, and by Great Britain under warrant of Orders in Council, induced Congress in December, 1807, to lay an embargo upon our foreign commerce. This absolute prohibition was mitigated later by the substitution of the Non-Intercourse Act. This milder act forbade foreign commerce only with France and England, but it did not prevent the continuance of foreign complications which culminated in 1812 in our declaration of war against Great Britain. The industrial outcome of these commercial restrictions and of the war which followed was almost to annihilate the importation of goods—and especially of manufactured goods—into the United States. The rates of duty on imports were doubled during the war in order to secure more revenue. This increase was of altogether minor importance, however, as the volume of foreign trade had dwindled to exceedingly narrow dimensions. This cessation of imports naturally gave an enormous stimulus to the introduction and extension of domestic manufactures. "The interruption of trade was equivalent to a rude but vigorous application of protection." [1] Our scanty supply of manufactured goods, especially of textiles, and the imperious necessity for the munitions of war made lucrative these avenues of production, and lured labor and enterprise from the bark and the plow to the spindle and the forge. Instead of being a nation almost exclusively devoted to agriculture and commerce, we were made perforce to introduce manufactures, and

[1] Taussig, Tariff History of the United States, p. 34.

upon the simple structure of our industrial constitution was superimposed the factory system.

In 1816 the high level of duties which had prevailed during the war was replaced by a lower tariff averaging about twenty per cent. This rate of duty, however, was the highest that had ever prevailed in times of peace. Some industries, moreover, were avowedly protected by this act. The textile industries were given special assistance by the imposition of a temporary duty of 25 per cent. upon the importation of cotton or woolen goods. After the return of peace the accumulated surplus of English manufactures poured upon our markets. To cap this came a period of general industrial depression in 1819, when at the same time the foreign market for our agricultural staples proved disappointing. There was much suffering both in manufacturing and in agriculture. A cure was sought in legislation, and the advocates of protection represented that policy as the remedy for the existing distress. The strongest support[1] of this policy was found in the middle western section, which wanted a reliable home market for its agricultural products. New England was at first opposed to the protective movement, fearing injury to her shipping interests. But as the factory system grew in that section, the opposition to protection became weaker and the protective sentiment stronger. The South early arrayed itself against the protective system. Slavery was incompatible with manufactures, and thus very naturally the South looked with little favor on a system designed in the first instance to benefit the manufacturing sections. In 1820 an attempt was made to alvance duties, but the project was foiled, and not until 1824 were the advocates of what Clay called the "American sys-

[1] Cf. Taussig, Tariff History of the United States, p. 70 *sq.*

tem" successful in raising the tariff rates. This movement reached its height with the passage of the so-called "tariff of abominations" in 1828. From this point the tide began to recede. Duties were lowered in 1832, and in the following year the so-called "compromise tariff" was passed, which provided for a gradual reduction of duties until a uniform level at 20 per cent. should be reached in 1842. The second era in our tariff history may be said to extend from 1808 to 1832. This period witnessed the inception of the factory system springing up under the exigencies of war, then upheld out of motives of national benevolence, and finally becoming the object of conscious solicitude and legislative favor until in 1832 the fickle tide of fortune turned.

From 1833 to 1860 the tariff was, or tended to become, a revenue tariff. Exception must be made only of the period 1842–46, when a slight protectionist reaction asserted itself. Nor must it be thought that even the Walker tariff of 1846 was in perfect consonance with the postulates of an ideal revenue system. That measure imposed taxes on certain raw materials such as wool; it also exempted from duty such distinctively revenue articles as coffee and tea. Still if we bar the early period prior to the second war with England, this era from 1846 to 1860 marked our nearest approach to the policy of a tariff for revenue only. This ended the third distinct phase of the history of our tariff policy—a phase which witnessed the subsidence of the early protectionist propaganda, and an empirical approach to a revenue system.

The customs policy of the nation for the next generation was determined mainly by the civil war and its legacies, political and financial. It is true that in 1859–60, before war was seriously anticipated, tentative

efforts were making towards a restoration of the protective rates of 1846. Such a measure passed the House of Representatives in the session of 1859–60, and was dangled as a bait [1] before the electorate of Pennsylvania, whose vote was subsequently cast in favor of Lincoln, the Republican candidate for President. This act had hardly become law by its passage in the Senate when the civil war broke out. Thereafter for a time the urgent need of revenue dominated all legislation. The internal revenue system [2] levied heavy taxes on the domestic manufacturer. This afforded another reason for advancing the rates of customs duties. Without such an advance the manufacture of certain articles in this country would be discriminated against. As Senator Morrill said, "If we bleed manufacturers we must see to it that the proper tonic is administered at the same time." In 1862 and again in 1864 there were general advances in the rates of customs duties, partly to offset the heightened excises, partly to afford more revenue, partly to afford additional protection. Measures the most extreme and far-reaching in their effects were rushed through Congress with inconsiderate speed and after inconsiderable debate.

The close of the war found us with a portentous tax-machine upon our hands. Those parts of the machine which were connected with the internal revenue were first overhauled and generally discarded. Practically all such excises as originally warranted the imposition of higher additional rates of customs duties were

[1] Such at least is the testimony of Taussig, Tariff History of the United States, p. 158; Sumner, History of Protection, p. 56. I do not know that this position is denied on the protectionist side.

[2] See p. 135.

repealed by 1872.[1] The income tax was lowered and then swept away. The duties on such typical revenue articles as tea and coffee were first reduced and then abolished. This allowed a reduction in the government's income, then vastly in excess of its expenditures, and at the same time prevented any material change in the protective duties. A horizontal ten per cent. reduction in the rates of duty was made in 1872 as a sort of offset to the repeal of the duties on tea and coffee. In 1873 and thereafter the industrial depression checked imports as well as the revenue they yielded; but in 1875 this ten per cent. reduction was repealed and the earlier and higher protective duties were reinstated. Thus "it is clear that the extreme protectionist character of our tariff is an indirect and unexpected result of the Civil War,"[2] no general revision, apart from the temporary ten per cent. horizontal reduction of 1872, occurring until 1883. In this latter year the various schedules were overhauled, and new tariff rates were established. There were some apparently considerable reductions in the case of particular articles. But such changes were frequently nominal, and in some instances really enhanced duties by different systems of classifying imports. The average *ad valorem* duty in 1883 was 42.4 per cent., and in the two subsequent years[3] 41.6 and 45.8 per cent., respectively. Hence the protective level was not seriously depressed by the Act of 1883.

In December, 1887, President Cleveland in his Mes-

[1] To make plain the relation of customs and an excise, let us suppose a tax of $10 a ton is levied on the home manufacturer of steel rails; in case no customs duty is imposed on imported rails, there would be a clear discrimination against the domestic producer. Nor until the duty exceeds $10 a ton is the duty protective.

[2] Taussig, Tariff History of the United States, p. 193.

[3] Cf. Statistical Abstract of the United States for 1893.

sage to Congress made an attack upon the system of protection, which he stigmatized as "vicious, inequitable, and illogical." In the previous presidential campaign the tariff had played a part, although the Democrats had not accepted it as the sole issue at stake. The President's Message in 1887 was practically an acceptance of the gage of battle, and determined the character of the presidential campaign in the following year. In that contest the Republicans were successful, and construed their victory as a popular mandate to preserve the protective system. The assault on that system had been made partly from the standpoint of finance. The government's income was in excess of its expenditure, and it was argued that a decrease in duties was the proper way to afford relief to the taxpayer. The solution of the question was attempted by the Republicans by generally retaining or advancing protective duties, by extending such duties to other industries, by abolishing the import duty on raw sugar,[1] and by making more liberal expenditures. The first three projects were embodied in the original McKinley bill, to which in the Senate there was tacked a Reciprocity amendment. This latter feature empowered the President to impose retaliatory duties upon countries sending to the United States sugar, molasses, hides, tea, or coffee, in case he judged the duties imposed by these countries on our products "unjust or unreasonable."

The significance of the McKinley bill, however, lay not so much in its heightened rate of duty on dutiable articles as in its embodiment of the new attitude of the adherents of protection. There had hitherto been a cer-

[1] This abolition of the sugar duty cut down the annual federal income by fifty millions or more. The sugar planters in this country were accorded bounties by way of compensation.

tain degree of relativity generally attaching to the doctrine. Hamilton, the great Coryphæus of protection, in his famous Report on Manufactures had said that "the continuance of bounties[1] on manufactures long established must almost always be of questionable policy, because a presumption would arise in every such case that there were natural and inherent impediments to success. But in new undertakings they are as justifiable as they are oftentimes necessary." Clay in his speech of 1824 had said: "Let our arts breathe under the shade of protection; let them be perfected as they are in England, and we shall be ready, as England now is said to be, to put aside protection and to enter upon the freest exchanges." Parallel expressions might be culled from the speeches of Garfield and Sherman, the successors of Hamilton and Clay. Protection had been regarded as a schoolmaster to bring us to free trade, or as a temporary concession to vested interests, or as a momentary fiscal expedient. But the new school of protectionists apparently regarded the system as a finality to be permanently maintained or even extended. Commercial isolation, rather than industrial maturity, was the essence of the new doctrine. The political reverses of 1890 and 1892 which befell the Republicans seemed to indicate that public opinion had begun to turn against extreme protection. In 1894 the McKinley bill was repealed and the so-called Wilson bill was enacted. The history of that measure is so recent that it is barely worth while here to recount how the original House bill, which moved decidedly away from the protective extreme, was amended in the Senate, and finally passed in a shape

[1] Hamilton speaks here, it is true, of bounties; but in a previous passage in his report when speaking of protective duties he remarks: "Duties of this nature evidently amount to a virtual bounty," etc.

which, while somewhat abating the higher duties, was essentially a protective measure except in the case of raw wool, which was placed on the free list. Owing to a number of causes whose nature is still a matter of dispute industrial depression began in 1893. The result of the election of 1896 was to put the protectionists again in power. The Dingley bill replaced the Wilson tariff and restored the high protective character of our customs duties.[1]

General Canons of Customs Taxation.—The foregoing recital of the alternating changes in our tariff policy ought to convince us of the whimsicalness of our electorate upon this subject. It must at the same time demonstrate the necessity of establishing, so far as possible, principles applicable to all tariffs, whether these tariffs be of the protectionist or of the revenue variety. Agreement upon such very general principles is of no little importance. Very frequently the lack of dispassionate discussion of the question of the tariff may be traced to the fact that instead of analyzing the operations of the tariff in the concrete, from the standpoint of administration, there has been a disposition to insist first upon a confession of faith on the main issue. Thereafter it is but a short remove to "the thunder of the captains, and the shouting," and that means an end of profitable discussion. Nevertheless there are certain general principles pertinent alike to revenue and protective measures; and in case these were generally acknowledged, the final solution of the greater issues might reasonably be anticipated. These general aspects of customs duties may be treated under the captions of incidence,—or the location of the burden of such taxes;

[1] For a brief summary of the revenue yielded by different schedules, see page 178.

variation,—their shrinkage and expansion; certainty, that is, their being calculable or dependable. Let us consider these phases of customs duties, beginning first with the one last mentioned. Whether we are to have a protective or a revenue tariff is a matter of comparatively little importance compared with the question whether the tariff system which we adopt is or is not likely to be subject to speedy and extensive changes. The existence of well-defined and stable law is frequently of more importance than the particular character of the law itself. Absence of law means anarchy, defects of law mean only injustice at the worst. Mr. Bryce in his American Commonwealth, in speaking of the smooth working of our complex governmental system, says that such men as the settlers of New England could work any constitution. Something of the same character may be said about our business men. They can thrive—ultimately at least—under any tariff, and their primary interest in the tariff to-day is not that it be high or that it be low, but that it be steady enough and dependable enough to remove the unknown and unknowable elements which its present instability creates in their business calculations. It is not possible even to summarize the different ways in which uncertainty in prospective tariff rates disturbs, depresses, and complicates various industrial enterprises. In case, for example, the tax on the manufacturer's raw material is likely to be advanced by the tariff, he will be strongly tempted to purchase large stocks thereof in order to anticipate the higher duty on such material in future. On the other hand, the enhanced price of the raw material must ultimately be reflected in a higher selling price of the product, and *ceteris paribus* in a decreased demand for the finished goods. So that the danger of accumulating dead stock must also be con-

sidered. The case is very similar to one of those cardboard puzzles where every section dovetails perfectly into the others, and where a change in the size or shape of a single piece renders reconstruction impossible, unless every other piece be reset. So a change in one item of expense will very probably necessitate a complete readjustment of the other items of mercantile cost. This readjustment will probably involve a certain amount of experimentation with its attendant risks. If hitherto there has been an upward swing in the trade, the customs revision may blight with uncertainty the prospect of further growth. If the trade has hitherto been flagging, a change in customs duties will often deaden the market and postpone the normal recovery.

The real difficulty here lies in finding concrete means to lessen the difficulties arising from tariff changes. Changes in tariffs from time to time must be made. Successions of surpluses or deficits in times of peace make tariff alterations politically inevitable. The necessity for more revenue in times of war often has the same effect. Four times in the last fifteen years our tariff has been overhauled. So long as the federal government is debarred from the taxation of incomes, it is hard to say how there can be introduced into federal finance any elastic element which might be used to make up a deficit.[1] Still, the financier may guide his feet in part by the lamp of experience. A moderate and temporary surplus or deficit may be less of an evil than a sweeping tariff revision, just as a stubborn case of indigestion may be preferable to an operation for appendicitis. There is also some considerable latitude in the choice of the time for tariff revision. In prosperous times changes may be made with ease and met with

[1] See p. 371, *note*.

complacency when the same change if made under other conditions would chill ardor and deaden enterprise. Considerable uncertainty might also be eliminated by the general substitution of specific duties for *ad valorem* duties.[1] It is generally conceded that specific duties are less likely to produce undervaluation and fraud than is an *ad valorem* system, where a virtual premium is offered to connivance and evasion. The main objection to specific duties is that with a fall in the prices of the dutiable imports the rate of taxation rises. While this must be admitted, the shoe is on the other foot when the prices of imports rise; and although it is probable that general prices at present are more likely to fall than to rise, it is undeniable that the greater certainty and uniformity[2] of specific duties make them on the whole preferable to the *ad valorem* system.[3] Finally it may be argued that there may be exercised some considerable choice in the selection of articles upon which the rates of duty are to be changed. Something may be said for the policy of confining the most extensive changes (whether up or down) to articles exclusively of foreign production. So long as these articles are not raw materials, such changes in duties will throw the immediate problem of recalculating the problem of cost upon the foreign producer, and to a certain extent upon the importer. Changes in the prices of these articles will of course alter the conditions of consumption, and finally affect indirectly the demand for all products. But the burden

[1] A specific duty is levied upon articles ordinarily by weight or bulk, e.g. a duty on coal of so many cents per ton. *Ad valorem* duties are assessed upon the estimated price of an article, e.g. a duty on wool of 20% of its value.

[2] I have heard importers claim that precisely the same kind of import was differently taxed at different ports of entry under the *ad valorem* system.

[3] Cf. Hadley, Economics, p. 457.

of readjustment is in the first instance at any rate imposed upon other industries than our own. We may then summarize these considerations thus:

Canon I. A schedule of customs duties should be as stable and calculable as general conditions will permit; if changes are made, they should be made at such times and by preference in such schedules as will introduce the least uncertainty into domestic industry.

The second aspect of customs to be here considered is the variation in their yield. The revenue netted by any tariff must depend on the amount of dutiable goods entered. How greatly such imports will fall off in bad times depends largely on what sort of goods a country imports. If they are food staples, the decrease will be less than if luxuries or conveniences were the chief imports. In the case of the United States, however, the variations in customs revenue are likely to be very great, and such variations are likely to create unusual difficulty in our finances. This great variation is likely to occur on account of the number and variety of our dutiable imports. Though the demand for some of them may not be very greatly curtailed by industrial depression, there are others whose consumption is violently checked, and perhaps as speedily recommenced when better times set in. The resultant of such changes is reflected in the astonishing variations in the yearly aggregate of customs duties. The following table[1] will illustrate this point:

[1] Taken from the Report of the Secretary of the Treasury for 1893, p. cxxiv. It should be said that the only important change in this period was a 10% horizontal reduction in 1872. The former rates were restored, however, in 1875, and then remained substantially unchanged until 1883.

RECEIPTS OF THE UNITED STATES FROM CUSTOMS FOR FISCAL YEARS ENDING

June 30,	1872.....	$216,370,286
"	1873.....	188,089,522
"	1874.....	163,103,833
"	1875.....	157,167,722
"	1876.....	148,071,984
"	1877.....	130,956,493
"	1878.....	130,170,680
"	1879.....	137,250,047
"	1880.....	186,522,064
"	1881.....	198,159,676
"	1882.....	220,410,730

It is worth while to insist on the fact that these variations are largely independent of the character of the tariff, whether protective or otherwise. The period covered by the foregoing table was a protective period, but incidentally coincided with a general ebb in business operations. Apart from the difficulties entailed by such a shrinkage of federal revenue, the peculiar danger to our federal finances comes from the fact that we rely to a far greater extent than any other nation of importance upon customs duties as a source of income. Whereas Great Britain and Germany derive from a quarter to a third of their imperial revenues from customs, we look to customs for a half or even two thirds of ours. The dangers resulting from an unexpected surplus if not so obvious as those caused by a deficit are perhaps even more insidious. They tend to produce extravagant appropriations which become only too fre-

quently fixed charges on the annual budget, and thus make a deficit when it again occurs the more difficult to get rid of. Many of these problems must be more fully considered under the discussion upon Public Credit and Treasury Management, but enough has been said in this place to warrant us in framing provisionally our second rule.

Canon II. A customs system under which large variations in the annual revenue are certain should be supplemented by some provision for meeting deficits by borrowing or otherwise.[1]

Equally applicable to protective and revenue tariffs is a consideration of the incidence or ultimate burden of customs duties. Nor must such an inquiry be confounded with that at issue between the protectionist and the free-trader. We may resolve every point in dispute in the matter of incidence in favor of the latter, and yet leave unresolved the question of the ulterior benefit of a protective system. If two boys between them are carrying a log, it is possible from certain data to judge whether the one who is doing the most grunting is also carrying the greater weight. But when this fact is known, we may still be in the dark as to whether such a task is simply developing his muscles or seriously overtaxing his strength. It is much the same with the question of the incidence of customs duties. When we have separated the question of "who pays the piper" from the further question whether after all he was worth paying for, we have facilitated the solution of the first inquiry by eliminating or, at least, by postponing the final conflict. If the gen-

[1] Strictly speaking this is a problem in Public Credit. It will be seen by reference to p. 371, *note*, that this plan has been partly adopted by virtue of the Act of June 13, 1898.

eral discussion of the problem of incidence[1] has been understood, it will be readily perceived that the imposition of duty upon an imported article will normally raise its price and curtail its consumption. In case it is produced abroad exclusively, and under competitive conditions, this contemporaneous rise in its cost and narrowing of its market must force certain producers ultimately to discontinue or decrease their former output. The new marginal producer will thereafter recover his expenses of production out of the price he receives, and this increased price must be borne by the consumer. Others will feel the effect of the tax in being forced to lessen or stop their consumption of the article. If the foreign producer had a monopoly[2] of an article, such as tea, it is possible that the duty imposed would first come out of his profits, and that the selling price in the importing country would remain unchanged, especially if an advance in the price of the tea seriously lessened its use. When the duty reached such a point that the profit realized by the foreign growers was no longer above the ordinary profits in the East, the first rule would come into operation, and the increments in the duty thereafter would ultimately fall on the consumer. Finally comes the case where part of the supply of an article is produced abroad and where another part is produced at home. It is obvious that on such articles as are imported the duty paid will be borne by the producer or consumer in accordance with the two rules just enunciated. The duty serves, in case the domestic expenses of production are greater than the foreign expenses of

[1] Cf. Chapter II (Part II).

[2] It must be remembered that it by no means follows that because an article is exclusively produced in one country its sale will be monopolized. It is more usual to find competition between the various foreign producers or exporters.

production, to offset the greater cost of the domestic product, and thus to render the home production of the article possible. Hence it is evident that the price paid per unit for the domestic product is greater than if the whole supply were imported. This greater price paid for the domestic product is virtually a tax upon the consumer, though it yields no money to the fisc, and no subsidy necessarily to the home producer. The principle is illustrated by the cases of sugar and whiskey cited by Mr. Thomas G. Shearman in his work on Natural Taxation[1] (p. 11). He says: "The tax upon foreign sugar is admittedly paid by our own people. For many years it amounted to 70 per cent. of the cost, and amounted to nearly $60,000,000 per annum. In addition to this, about 180,000 tons were annually produced at home, the price of which to the consumer was increased by at least two cents a pound by the tariff, or about $8,000,000 in all. Either the whole of this $8,000,000 went into the pockets of a few sugar-planters, or, which is more probable, they only gained half of it, while the other half was wasted in misapplied human effort." Whether this sum was "misapplied" depends, of course, upon the view one takes of diversifying domestic industry and similar arguments urged in support of the protective system. Into that wider question we do not here enter, but shall content ourselves with summarizing our conclusions in the third rule.

Canon III. The levying of customs duties should proceed upon the assumption that the incidence of such taxes will be normally upon the consumer unless the taxed import be produced exclusively abroad under monopoly conditions.

[1] I will not vouch for the accuracy of Mr. Shearman's estimate.

The Revenue Tariff System.—It has already been pointed out that the two distinct objects—protection and revenue—which most tariffs are designed to promote are largely incompatible. Such measures aim, therefore, not only to realize a double purpose, which is difficult, but to reconcile cross-purposes, which is impossible. They must in consequence become mere mechanical compromises on the one hand, or concealed surrenders on the other. It is therefore with a sense of relief due to the simplification of the problem that the student of finance turns to the discussion of a tariff system founded exclusively on financial considerations. Such a tariff we call a revenue tariff. By this we mean a tariff system which makes revenue the one paramount consideration, and which is not designed to afford to domestic industry any shelter from outside competition. Such a system does not imply that the revenue raised in virtue thereof is the greatest that could possibly be extorted without contravening the general principles of a revenue system; but simply that the sole aim in levying duties is to raise revenue. Whether the aggregate of such revenue be great or small ought to depend on the current expenses of the government.

Viewing the matter *from a financial standpoint exclusively* we may pronounce a revenue system definitely superior to a protective system, first, because it will normally produce more revenue in the aggregate from each particular import taxed; secondly, because it simplifies the whole problem of the construction of a tariff by eliminating the disturbing factor of protection[1]; third,

[1] It is of course open to the protectionist to argue that the financial disadvantages of a protective tariff are more than offset by the ulterior effects of protection in diversifying industry, in effecting a more advantageous distribution of the national income, and in thus rendering the ultimate sources of private income, and therefore of public income, more copious than they could otherwise be.

because a revenue tariff does not take more from the pocket of the taxpayer than it turns into the Treasury.[1] "Whatever be the details of the working of a protective duty," says Professor Taussig,[2] "it is *prima facie* less desirable than a revenue duty, on the simple ground that the tax serves not to yield revenue, but to offset the greater cost of making the commodity at home." Even though importations because of the high duty cease altogether, and though the domestic price may be less than the price of the duty-paid import, there is levied upon the purchaser a concealed tax in the higher price, for it could not be exacted did a lower duty allow the article to be brought in from abroad. In the case above cited the tax ordinarily serves to cover the greater cost of producing the article at home, and no part of the tax thus surreptitiously levied finds its way into the Treasury vaults.

The framing of a revenue tariff involves, first, the choice of articles on which to levy import duties, and, secondly, the ascertaining of those rates which will afford the revenue sought. To secure adequate revenue such articles must be chosen as are imported in great quantity and for which the demand is relatively stable. It is also highly desirable that these articles should be mainly of foreign production and, where possible, finished products rather than raw materials. The reasons for the last two qualifications are plain. Goods produced exclusively abroad will not, when taxed, raise the

[1] At least it does not have this effect if supplemented by corresponding excises on such domestic products as might otherwise be protected by a purely revenue duty. Whether such a corresponding excise be imposed or not, the indirect cost of a revenue tariff is considerably less than that of a protective tariff, because a revenue tariff by preference selects for taxation articles exclusively of foreign production.

[2] Tariff History of the United States, p. 187.

prices of domestic products. Thus they will not levy what is substantially a tax (never received by the government) in the guise of higher prices paid for the domestic product. In case, however, considerations of revenue require us to levy duties on imports which compete with domestic products, the protection thus incidentally afforded the home producer may be offset by levying on every unit of the domestic product an excise exactly equivalent to the import duty.[1]

The considerations which dictate the exemption of raw material are that its taxation hampers at the outset all industries which depend on the supply of the raw material.[2] Where industrial development, however, has concentrated the elaboration of the raw material in a very few plants, such a tax on the raw material may impose but little burden on the manufacturers, and but little difficulty on the tariff administration. Sugar refining in the United States would perhaps be an instance of this rather exceptional state of affairs.

From this standpoint such articles as tea[3] and coffee would be ideal objects for subjecting to customs duties upon their importation into the United States. Raw sugar (from which at present millions of revenue are

[1] This is the English system. Corresponding to such excises most governments allow the home producer a drawback on the exportation of materials which when imported were subjected to a duty. Unless this were done, the home producer would be handicapped in foreign markets.

[2] The contention that the enhanced price of the raw material is reflected in a higher price of the finished product because interest or profits are computed on a higher expense at the start and increase in a geometrical ratio on every turn-over thereafter, is offset largly by the earlier date at which the Treasury derives its revenue. The real reason for objecting to the tax on raw material must be based rather on the hampering of industries using the raw material.

[3] Since this was written the Act of June 13, 1898, subjected tea to a duty of ten cents per pound.

derived) approximately meets the tests above mentioned. Tropical fruits of various kinds are very properly required to contribute to our customs revenue. On the other hand, it will readily appear that such articles as the manufactures of wool and cotton are not fit subjects for customs duties, although the large investments in these manufactures may dictate moderation in any proposed reduction or abolition of existing duties.

In general, it may be said that a revenue tariff will embrace relatively few articles in its list of taxables. When, on the contrary, protection is designedly afforded to domestic industries, the tariff list must embrace hundreds and even thousands of commodities.[1] Even in this latter case it is generally found that the bulk of the revenue comes from relatively few articles. In the United States, for example, in 1895 four articles—sugar and the manufactures of wool, cotton, and silk—constituted a third of the total value of the dutiable imports brought to our shores. Six other articles—the manufactures of textile grasses, tobacco, chemicals, tin plates, fruits, and liquors—made another third. Obviously the fewer the articles taxed, the less will be the cost of collecting customs duties.

Assuming then that choice has been made of such articles as ought on the principles of a revenue tariff to be taxed, what rates of duty ought to be imposed? This inquiry is entirely independent of the question whether duties should be imposed on a specific or an *ad valorem* basis. The tendency of specific duties to operate so as to automatically increase the degree of protection when the price of the taxed article falls has created a liking for

[1] Such is the case at present in the United States; in Great Britain, on the contrary, there are not more than half a hundred articles liable to import duty, and but a dozen of these are important as sources of revenue.

ad valorem duties on the part of the opponents of protection. This question, however, of the basis on which duties should be imposed is essentially a question of administration, and has no bearing on the proper issue here under discussion.[1] On the supposition, therefore, that the articles chosen for tariff duties are to afford the maximum of revenue, the rates of duty must be so set that the total imports at those rates of duty must when multiplied into the respective rates yield the maximum sum. Here a certain amount of experimentation is necessary. But theory as well as experiment goes to prove that such rates of duty must be under the rates ordinarily imposed by a protective system. This was clearly pointed out by Adam Smith in the Wealth of Nations[2] where he says: "High taxes, sometimes by diminishing the consumption of the taxed commodities, and sometimes by encouraging smuggling, frequently afford a smaller revenue to the government than what might be drawn from more moderate taxes. When the diminution of the revenue is the effect of the diminution of consumption there can be but one remedy, and that is the lowering of the tax." This can be readily seen in the limiting case. A tariff so highly protective as to exclude imports altogether would produce as little revenue as absolute free trade. To afford any protection, duties must be so high that importation will be curtailed, and thus one of the factors whose product determines the customs

[1] Under a revenue tariff there would of course be no necessity for "mixed" or compensatory duties. An example of such "mixed" duties was afforded by the tariff on woolen goods under the Act of 1883. Raw wool was taxed to protect the native wool grower. Then to protect the domestic wool manufacturer woolen goods were doubly taxed. First a tax was laid on the estimated amount of raw wool required to make the goods, and then a second tax was levied upon the goods in order to protect the domestic manufacturer.

[2] Book V., Chap. II., p. 481 in Vol. II. of Rogers' edition.

revenue is lessened. Hence revenue rates will normally be below protective rates of duty.[1]

To foretell the future of our tariff policy in the United States is, of course, impossible. Our past history ought to warn us from even attempting to prophesy. But, barring the case of war, there are what appear to be at least significant indications of the course which tariff legislation is likely to take. First of all, it will not be likely to take very radical steps in any direction. The power of vested interests alone will probably prevent any rapid transition to a revenue system. On the other hand it seems not improbable that the halcyon days of ultra-protectionism are numbered. The woolen manufacturers have had a taste of free wool, and some of them at least were not over-anxious to return to the old system. Our manufacturers in many other quarters are beginning to realize that there is a foreign market, and their dreams of conquest include the markets of the world. The farmer has recognized that, wool apart, his benefit from protection is purely nominal. The transportation companies also are realizing that their greater interests are wrapped up in expanding commerce. So that it seems not impossible that another generation may see the proximate realization of a revenue system in the United States.

[1] It is conceivable that a number of different rates of duty will net the same revenue. Thus if under a rate of 50 cts. a ton 100,000 tons were imported, the revenue would be $50,000; if at a rate of $1 a ton 50,000 tons were imported, the revenue would also be $50,000. Indeed it is possible that at the higher rate the imports might be 60,000 tons, in which case the revenue would be $60,000. Here the higher rate both affords more protection and more revenue. Experience shows that this is, however, an exceptional case. Moreover, the higher price (resulting from the higher duty) charged to consumers of the domestic product is an unseen extra tax which is levied by virtue of the higher rate. It is an instance of the curtailment of "consumers' rent."

CHAPTER VIII.

THE INCOME TAX.

Nature of Income Taxes.—The preceding chapters have described the system of taxation as it exists to-day in the United States. The present chapter will treat of the income tax,—a fiscal resource which most theoretical financiers incline to think we cannot do long without, but which has not as yet won for itself a lasting place in our system. Besides the theoretical interest attaching to the subject much that is valuable historically is found in the history of such taxes in the United States. for we have had two federal income tax laws,—

> " . . . one dead,
> The other powerless to be born."

and the untimely fate of either is big with significance.

But, first of all, what is meant by *income?* We may be tempted at the outset to say of income, as Mill unfortunately said about wealth, that every one has a sufficiently correct notion for general purposes of what income is. Most people have, or think they have, a pretty sharply defined idea of the size of their income,—at least of last year's income,—which they commonly express in terms of dollars and cents; and this mercantile approximation is certainly indispensable in every-day life. But, like many another idol of the market-place, the commercial conception necessitates a somewhat sharper

complementary scrutiny than might be suspected.[1] If we confine ourselves to such kinds of wealth as belong to individuals in their private capacity, that is to say, if we exclude goods like air and sunlight that are free to all, and if we also exclude public property, such as government buildings, which belong to us all alike, we have a vast mass of property the use of which affords the property owners a calculable amount of advantage. These advantages constitute the income, or a part of the income, of society. It is not at all necessary that property in order to afford an income should first pay a certain amount of money into its owner's pocket. One's stable affords as true an income as one's stocks; one's bicycle as true an economic advantage as one's bonds; the dwelling-house which one occupies, as indisputable an income as the tenement one lets to another for a money rent. The commercial view is liable to err just here, and to count as income those receipts only which accrue in current coin. In addition to income received from property, much income—perhaps the greater part in the aggregate—comes from service or labor[2] performed either directly for one's self or for another, who makes a return, often in money. Strictly speaking, therefore, one's income, from an economic standpoint, consists for any given period in the sum total of advantages he derives from his property (directly or indirectly, by immediate use or through handing it over to others for a consideration) *plus* the advantages derived immediately or mediately from his own labor or exertions. Or, briefly put, income is the

[1] *Vide* Hadley, Economics, p. 5 *sq.*; Cannan, Elementary Political Economy, p. 39 *sq.*

[2] *Vide* Nicholson, Money and Monetary Problems, 2d edition, Part II., Ch. XII., The Living Capital of the United Kingdom.

sum of economic benefits received in a unit of time, ordinarily a year. When this *flow* of advantages, measured in money terms, is taken as the basis for imposing taxes, we are in the domain of income taxation.[1] Paradoxical as it may seem, the economic conception of income is clear just because the conception is abstract. When the legislator is compelled to frame an income tax law he frames a ponderous inventory of concrete income sources; and fine as the tax net may be woven, much that, in the economic sense, is real income slips through its meshes.

History of Income Taxes in England.—The income tax is not yet a century old, and is the most salient illustration of the general tendency in modern finance to increase the proportion of the national revenues derived from direct taxation.[2] Like so many other war expedients, the English income tax belongs to the numerous progeny of Necessity, having been instituted by Pitt in 1799 as a war tax. It was temporarily repealed in 1802 on the prospect of peace, but the resumption of hostilities the next year saw the tax reimposed, and that, too, in the scheduled form which it still bears. The clamant exigencies of the struggle with Napoleon induced the British taxpayers in 1806 to submit to a ten per cent. tax on incomes, and it is not surprising that, after staggering under an incredible tax burden for years, England rose in stubborn revolt in 1816, after the final defeat of her antagonist, and for a time shook off the income tax

[1] If the *property* which yields the income is taken as the basis, the tax is the general property tax. *Vide* Ch. V.

[2] "The modern tendency in England has shown a remarkable movement in this direction, over 40 per cent. of the national income now coming from direct taxation, as compared with 25 per cent. a quarter of a century ago." H. Higgs, The Physiocrats, p. 144.

altogether. Such radical action was very natural, very excusable one might almost say, except that it led to a long series of deficits and presented more than once the lamentable picture of a "chancellor of the exchequer seated on an empty chest, by the pool of a bottomless deficiency, fishing for a budget."[1] Not until 1842 was the unpopular tax reimposed, and then only with the understanding that it was to be but a stop-gap. Mr. Buxton has concisely outlined its history.[2] "Revived as a temporary tax," says he, "for a specific purpose, it still remains—*il n'y a que le provisoire qui dure*—and is on a more permanent footing than ever. Originally imposed by Pitt as a war tax; revived by Peel for three years for the purpose of placing the finances of the country on a sounder basis and to promote fiscal and commercial reform, it was renewed another three years for the same purpose. Again renewed for a like period in order to fill a void, annually renewed for a couple of years, it was then in 1853 voted for a provisional period of seven years, and was again combined with fiscal reforms and remission of other taxation. But war[3] broke out almost at once, and the tax was again utilized for its original purpose. Subsequently reduced to the old sevenpence (i.e. seven pence per pound, or about 3 per cent.), from that time onward it has been a yearly tax, and has varied in amount between the 10*d.* of 1860 and the 2*d.* of 1874 and 1875."[4]

It is not uncommon in works on finance to hear of the advantages and defects of income taxation,—by which is ordinarily meant income taxation in Great

[1] Dowell, History of Taxation and Taxes in England, Vol. II., p. 315.
[2] Buxton, Finance and Politics, Vol. II., pp. 169, 170.
[3] The Crimean War, 1854.
[4] The rate at present is 8d. per pound.

Britain, so that it will be worth while to describe the present English tax somewhat in detail. The official name of the tax, to wit, the "property and income tax," serves as a sort of blanket title for five kinds of taxes imposed on five separate sources of income. Generally speaking, no attention is paid to the aggregate income of any taxpayer, but each of his sources of income is levied upon. Under Schedule A incomes derived from lands or houses owned are taxed. In case the property is mortgaged the tax paid by the mortgagor may be deducted from the interest he owes the mortgagee. In estimating incomes under Schedule A an abatement of one eighth in farm rentals and of one sixth in building rentals is conceded as a sort of compensation for the estimated cost of repairs and insurance required. Schedule A comprises, therefore, the incomes of the owners of real estate. It is, however, the occupier of the property who in most cases advances this tax, subsequently deducting the amount thereof when next he pays his rent. Schedule B includes the income of the occupiers of land, especially tenant farmers, and also such owners as are in actual occupation,[2] the amount of such income being based on a certain proportion of the annual rent. Bondholders are taxed under Schedule C, and have their taxes deducted by the Bank of England out of the interest on the public securities they own or the annuities they enjoy. Similarly, Schedule E comprises incomes derived from government salaries and pensions, and from public corporation salaries, out of which the

[2] "Originally the occupier pays both taxes (A and B) where they are chargeable, and subsequently, if a tenant, deducts the tax under Schedule A from the next payment of rent to his landlord." Dowell, *op. cit.*, Vol. III., p. 114.

tax is deducted before the residue reaches its final destination. In these four schedules the method of stoppage at the source is applied with a fair degree of success, but Schedule D, the drag-net tax, professedly covering all other incomes, such as those derived from trade, professional service, and wages, is assessed upon returns made by the taxpayer. This schedule yields nearly one half of the aggregate revenue derived from the income tax, and allows, of course, the usual amount of evasion which self-assessment always produces. Incomes under £700 are assessed not on their full value, but are allowed abatements, and all incomes under £160 are exempted altogether under Schedule D. The incomes of charitable institutions, schools, and provident societies are exempt from the income tax, and life-insurance premiums are deducted in computing income.

General Characteristics of Income Taxes. — Whether a colorless, theoretical discussion of the general principles of income taxation is likely to prove very fruitful may well be doubted. For income taxes, as we find them in operation, are not a mere 'bloodless ballet of categories' financial, but generally a set of fiscal expedients differing from country to country, originally imposed by necessity and retained through despair of finding a less obnoxious substitute. Prussia, to be sure, has a model income tax, "not ideally perfect," it is conceded, "but laid down in accordance with the general principles enunciated"[1] by sound finance, one of whose dicta, it is rather curious to observe, is the declaration of income by the taxpayer,—a device which, experience has taught, leads always to fraud. Italy, too, has an income tax which, like "the property tax in the United

[1] Plehn, Introduction to Public Finance, p. 236.

States, is ineffective through evasion." [1] But after making all allowances for innumerable differences in detail, there are certain considerations, somewhat attenuated to be sure, which apply to income taxes generally.

Historically considered, income taxes have been more or less successful efforts to throw an increased share of public expenses upon the wealthy. Put into the technical language of finance, this phase of income taxation is generally summed up in the phrase—Equalization of Taxation. Evidently, where taxes are imposed upon the great staples of consumption, whether manufactured at home or imported from abroad, the consumer in general [2] bears the burden of the tax. It will therefore often happen that such indirect taxation absorbs a greater part of the smaller incomes than of the larger incomes. Such inequality sins against the canon of distributing public burdens in proportion to each taxpayer's ability, and may therefore be redressed, in part, by an income tax exempting the lower incomes [3] or abating the rate of income tax imposed thereon. How far existing inequalities of taxation may be redressed by an income tax will depend, of course, upon conditions peculiar to each nation. It is worthy of notice, however, that very serious injustice may be perpetrated by this compensatory scheme. It may happen, it sometimes has happened, that while the income tax has redressed inequalities as between the recipients of the largest and the

[1] Bastable, Public Finance, p. 451 *sq.* Bastable admits, however, that "Italian finance has found a powerful source in this form of taxation."

[2] See p. 174.

[3] Jevons estimated that in England families with incomes of £40 paid in taxes 10% of their income; families with incomes of £85, 8.2%; families with incomes of £500, 8%. See also Cliffe Leslie's Essays, p. 393 *sq.*; also Buxton, Finance and Politics, Vol. I., p. 311.

smallest incomes, this gain has been purchased by unduly burdening the moderately low incomes. The heaviest burden in England once fell, as Sir James Graham expressed it, "where the fustian jacket ends and the cloth coat begins."

"There is no class of the community," said Mr. Lowe in 1872, "who are so severely pinched by taxation as the lower class of income taxpayers. Everything seems to hit them; they pay income tax, they pay house tax, and their principal consumption is the consumption of articles on which taxes are and still will be retained. Their tea, their coffee, their sugar, their spirits, their beer, all contribute to the taxes, and then they are heavily amerced in taxation in the shape of local rates. I do not think that any class pay so much as the poorer part of the income taxpayers." [1]

Naturally enough, it is proposed to obviate this injustice by abatements in the tax rate on the smaller incomes, or by a progressive rate of taxation upon all incomes. But the productivity of the tax will suffer thereby, and its effective enforcement will be somewhat impaired. Still, when everything is said by way of allowance, it must be conceded that an income tax generally serves to modify the injustice of the tax burden which indirect taxes invariably create.

Besides redressing the inequalities of taxation, an income tax, it is often maintained, serves as a most useful fiscal instrument quickly available in times of war—"a third line of defence," as it has been termed—and capable also of quickly making good a deficit in times of peace. The English income tax has acted as a buffer, serving at one time to obviate deficits, and again as an easy means of relaxing the strain on the taxpayer when

[1] Buxton, Finance and Politics, Vol. I., p. 311.

a surplus of revenue seemed probable. The utility of such a tax in time of war cannot be gainsaid, for, with the administrative machinery in running order, no source of revenue responds more quickly to present needs, or yields supplies more steadily, than a tax on incomes. Less can be said on the score of using the tax as an easy means of securing equilibrium between current receipts and expenses. In England alone is the annual rate of income taxation readily variable, and that possibility involves with it the English system of responsible cabinet government, which, be its merits what they may, is not likely to be speedily domesticated in the United States or (in its genuine form) on the Continent.

The defects of income taxes cannot be deftly covered up by remarking that an income tax is but a part of a system of taxation, and by suggesting that its imperfections may all be made good by the other taxes in the system. The glaring defect in an income tax is that much real income never is and never can be discovered and taxed. The principle of stoppage at the source, where applicable, is an admirable expedient for preventing evasion, but no income tax ever devised can prevent fraud when the taxpayer is allowed or required to disclose his own income. This is deplorable, perhaps derogatory to the dignity which hedges the citizen, but it is demonstrably true, and is not likely to change yet awhile. If the tax officials are charged with ascertaining the income of the contributor, the result will be the same—much income will escape—and the taxpayer's irritation will nevertheless be great. If certain legal presumptions are relied upon, such as the amount paid annually for rent, the result must be arbitrary and vexatious, while much income will not only not be disclosed, but will be permanently hidden as it were behind a screen

erected by law. If one is asked what is the remedy for this inevitable defect in income taxes, the answer is that there is none. To suggest the general property tax as a remedy—even as a complementary remedy to the income tax—shows little knowledge of the true inwardness of taxation. The two taxes taken together, if they are fairly administered, may conceivably, under certain circumstances, be better than either by itself, but to suggest that they "realize justice" is certainly to adopt a complaisant view of finance. The other view, that justice in taxation can never be realized except in a very moderate degree, is not pleasant either, but on the other hand is rather nearer the truth.

The alleged defect of an income tax as it is generally set down in works of finance, is its failure to discriminate between different kinds of income. There seems to be a tolerably general acquiescence in the dictum that temporary incomes ought to be taxed at a lower rate than permanent incomes, and that incomes from personal exertions at a lower rate than incomes from property.[1] Leaving for the moment the source of income out of the question, it is certain that no reason exists for the gentler treatment of temporary incomes than of permanent incomes—if indeed there be any permanent incomes. The income received for ten years is taxed only so long as it is received, and if another income accrues for thirty years it must bear its burden for the longer period.

Whether property incomes should be treated in a different way from exertion incomes is a more difficult

[1] "L'impôt générale sur le revenue doit demander une moindre quote part aux revenues aléatoires, périssables et provenant de l'activité personelle, qu'aux revenues fixes, certains, perpetuéls, qui proviennent d'un capital accumulé." Leroy-Beaulieu, Traité des Finances, Vol. I., p. 445.

question. If the different rates were practicable, that is, if the distinction could be made without leading to grave administrative difficulties,—which is doubtful,—or if the higher rate on property incomes served only as a counterweight to the presumed evasion of taxes rightly due by property owners as a class, something might be said for the proposed plan of discrimination. But if it is to the interest of society, as well as of the individual, that property should be accumulated, the amercing of incomes derived from property at a higher rate than those springing wholly from personal exertions would seem to be a curious incentive to offer men to amass durable property. Such discrimination in taxing the two kinds of income would act in part as a premium upon such production as takes the form of goods that perish wholly in the using.

Income Taxes in the United States.—The story of income taxes in the United States cannot be invested with much novelty. It has been thoroughly exploited, and that recently.[1] The only effect invariably produced by the study of the subject, whatever be one's personal views, is multitudinous irritation. *Difficile non scribere satiram* might have been truthfully written of this theme. There is, however, in the first place, no demurrer to the verdict that the state income tax, as it exists in three commonwealths (Virginia, Massachusetts, and North Carolina) is a mockery. Whether the federal war income tax was a success depends largely upon the conception one holds of success in matters financial. But it will hardly be worth our time in this place to follow the serpentine windings of the legislation which shaped

[1] See Professor Dunbar's article in the Quarterly Journal of Economics, Vol. IX.; also Professor Seligman's article in the Economic Journal, Vol. IV.

and reshaped the war income tax.[1] Congress in 1861 committed the nation, temporarily at least, to the policy of taxing incomes, and for over ten years (from 1863 to 1873, both inclusive) receipts from income taxes figured among the federal revenues. The last lease of life accorded the tax was a two-year extension decreed in 1870. After 1873 this source of supply dried up completely.

Into the ever-changing details concerning the tax rate, the progressive charges on higher incomes, the limit of exemptions, and the methods of enforcement, it would be profitless here to enter. Suffice it to say that the highest rate ever in force was 10 per cent., the lowest 2½ per cent., while the exempted incomes varied from $600 to $2000. The highest yield for any one year was $72,982,159 in 1866. Perhaps of more significance than anything about the war income tax is the fact that, though Gallatin had suggested such an expedient at the time of the second war with Great Britain, the federal government had never before employed such a fiscal agency. It was only one instance of the high-water mark of the doctrine of federal powers. The law's repeal was due to its unpopularity in the older and wealthier parts of the country, to the receding wave of centralization, and to the reduced expenses resulting from the establishment of peace. Almost a quarter of a century elapsed before another income tax was placed upon the federal statute-book.

Most histories of the income tax of 1894 begin with some reference to the 'mandates' of 1890 and 1892. A 'mandate' is what the politicians of the successful

[1] A thorough study of the Civil War Income Tax by Mr. Jos. A. Hill is to be found in the Quarterly Journal of Economics, Vol. VIII., p. 416 *sq.*

party think the electorate wants, when the majority in the last election has been decisive. Such mandates might serve as useful indices of the trend of public opinion, if the electorate had not as many minds as an old woman, and did not change them as frequently. But however this may be, the inference from the general elections, congressional and presidential, in the years above mentioned, seemed very obvious. General Harrison had been elected on the issue of protection, and the McKinley Tariff bill was certainly a vigorous redemption of party and platform pledges. The success of the Democrats in 1890 and 1892 could be construed only as a popular condemnation of the principle of protection, and accordingly the Democratic party leaders in 1893–4 began to shape a measure which would, as they hoped, accord with the views of the majority of the people, as indicated in the election of Mr. Cleveland and a Democratic Congress. The crisis of 1893, whose causes are still a matter of dispute, came in to complicate the problem, and the early repeal of the silver purchase clause of the Act of July 14, 1890, sowed the seeds of dissension in the then dominant party. The dilemma which now confronted the Democrats was to redeem their pledges to scotch the principle of protection, and at the same time to obtain adequate revenue to carry on the government, for the deficit under the last year of the McKinley bill, owing largely to the dwindling volume of imports, was taking on portentous dimensions. It soon became evident that there were two very divergent elements that had been consolidated under the Democratic standard. There was the old-time conservative body whose hereditary economic ideal was free trade (tariff for revenue only) and hard money. There was also the faction of discontent, especially in the farming sec-

tions of the South and West, whose grievance was the absence of such prosperity as they felt themselves entitled to, and who opposed protection, not so much because of any very carefully reasoned economic convictions, but because it was a tangible part of a system under which they did not seem to thrive. The two branches could unite readily as a party of opposition, but harmony in constructive legislation was to be obtained only at a great cost. The radical section demanded that the tariff measure should redress the grievances of the South and West. These parts of the country were largely agricultural. They sold in a free market and bought in a protected market. The South, moreover, was in a still greater plight than the West, for no considerable part of the lavish pension expenditure of the federal government drifted back to the South, to alleviate the tax burdens it bore. The temper of the House was aroused. It was not so much the yield of the new revenue measure that concerned that body (as may be judged from the way in which it rejected, at first, the revenue duty on sugar), but it was upon a redistribution of the burden of federal taxation that the House was bent. The income tax became an integral part of the Wilson bill, which was passed and sent to the Senate. Here the House measure was subjected to a merciless revision, generally in the direction of lessening the breaches the original bill had made in the protective system, and also in the direction of increasing the total revenue to be derived from customs duties. The income tax provisions, though opposed by the senior Democratic senator from New York, remained intact, though limited to five years' duration, and the remodelled measure was forced upon a reluctant House and became law without the President's signature,

What the result might have been had the law gone into operation can only be surmised. But the Supreme Court, in May of the next year (1895), first maimed and then destroyed the tax by pronouncing it unconstitutional. Perhaps no more pregnant decision was ever handed down from that tribunal, for, be its future effects what they may, the abolition of the tax took from the administration its last financial resource, aggravated the deficits that were already become chronic, split the two wings of the Democracy into factions hopelessly embittered, and, as much as any other one thing, made the question of the free coinage of silver the issue in the presidential campaign of 1896.

Voltaire once remarked about some tax law that no burden the law imposed could be compared with the burden of reading the law through, and the remark seems apposite after one has perused Sections 27–36, inclusive, of "An Act to reduce taxation, to provide revenue for the government, and for other purposes," passed by Congress August 15, 1894, and popularly known as the Wilson bill. The sections above referred to were those which provided for the taxation of incomes. They required that a tax of 2 per cent. on net incomes [1] should be paid on or before July 1, 1895, and each year for four years thereafter. The basis on which the estimate was to be made was upon the income for the calendar year preceding. Private incomes enjoyed an abatement of $4000, although the incomes of corpora-

[1] In estimating incomes, deductions were allowed for necessary expenses of production, for interest paid, for losses by fire, shipwreck, and for taxes paid (except against local improvements); the incomes of charitable and educational institutions, building associations, mutual insurance companies, federal bondholders, and certain savings banks were exempt from taxation.

tions were permitted no such privilege. The assessment and collection of the tax were intrusted to the internal revenue officials, and minute provisions were made for the collection of returns, the exaction of sworn statements, the imposition of penalties, the conduct of appeals, and the enforcement of secrecy, which was enjoined upon the administrative staff. Individuals were required to return upon oath their total incomes. The principle of stoppage at the source was applied sparingly,—only to government salaries and to corporation dividends, but not to the interest on corporate indebtedness.[1] Another curious feature was that inheritances of personal property were included as income for the year in which the inheritance was received.

Criticism of the Income Tax Law of 1894.—After the income tax law of 1894 had been introduced into Congress and had ceased to provoke surprise, it naturally began to excite praise or vituperation, as the case might be, and shortly thereafter the period of naïve criticism began. The supporters of the tax often contented themselves with the deliverance that income was the fairest index of taxpaying ability,—a generality rather trite at best, and in this instance wholly inconclusive. The opponents of the tax rushed at the $4000 exemption clause, and pronounced the measure "a tax on thrift" and essentially socialistic. The innocent assumption underlying this assertion was that prior to this tax the equities of tax distribution had been so nicely adjusted that any addition to our taxes must throw the delicate tax mechanism wholly out of equilibrium. Some opponents of the tax contended that the tax was "inquisitorial." If, as Doctor Johnson once remarked, "patriotism is the last refuge of a scoundrel," "inquisitorial taxation" is

[1] Such as corporation bonds.

likely to be the first objection raised by a reluctant taxpayer. The same objection when brought against the war income tax—and with much better reason [1]—was readily met by Commissioner Delano, who answered that he did not see why this objection might not, with equal force, be urged against all taxes on personal property. "Such taxes," said he, "cannot be collected without ascertaining the amount of taxable property possessed by the taxpayer. The law imposing a tax on income does nothing more than this, if so much." [2]

Of course any adequate estimate of the income tax involves the careful weighing of a number of considerations. Perhaps the question first worth asking is whether the tax would have yielded the adequate amount of revenue needed at the time it was passed. The Statistician of the Treasury Department made an estimate while the bill was pending that the tax would yield the first year not less than 12 nor more than 39 millions of dollars, and expressed himself as thinking that the lower limit was nearer the probable yield. This was not borne out by the returns made to the Internal Revenue Department, for, even after the tax on rentals had (owing to the first decision of the court) been given up, it was anticipated that the residual yield would be in the neighborhood of 15 millions, so that had this tax stood intact it might very likely have yielded 30 million dollars a year in the aggregate—a sum which the Treasury sorely needed, and which would have wiped out the greater part of its recurring deficits. Though its administrative defects, therefore, may have been grave, there is little

[1] Incomes during war time were sometimes printed in the newspapers as items of public interest.

[2] Bolles, Financial History of the United States, Vol. III., p. 406.

to be said against the tax on the score of inadequacy. It was not the least bitter part of the irony of fate that the income tax, which the Administration accepted only with reluctance, would have enabled it to avert its humiliating deficits, while those who originally proposed the tax designed it as an instrument to secure equity in taxation rather than as a needed source of supplementary revenue.

The tax would have operated also to reapportion the burden of federal taxation more equitably. At least there is very good reason to think so. Senator John Sherman, in opposing the repeal of the war income tax, said truly and prophetically: "A few years of further experience will convince the body of our people that a system of national taxes which rests the whole burden of taxation on consumption, and not one cent on property or income, is intrinsically unjust. It will not do to say that such a person consumes in proportion to his means. It is not true. Every one must see that the consumption of the rich does not bear the same relation to the consumption of the poor as the income of the one does to the wages of the other. As wealth accumulates this injustice in the fundamental basis of our system will be felt, and forced upon the attention of Congress."[1] Mr. Sherman's verdict in this matter was indisputable, and much the same might be truly affirmed of the income tax law of 1894. Defects in the measure there were, nor were they few in number or of slight importance. The principle of stoppage at the source might have been applied more extensively, especially to the interest paid by corporations upon their bonded indebt-

[1] Bolles, Financial History of the United States, Vol. III., p. 406. It is also rather curious to note that Senator Sherman pronounced the former income tax "the most just and equitable tax that is now levied in the United States, without exception."

edness.[1] The productivity of the tax was markedly lamed by this omission. The exemption limit of $4000 seemed also to countenance a propaganda of confiscation, though it should be remembered that the exemption under the first income tax was finally set at $2000. The productiveness of the measure also was largely curtailed by this high exemption limit, and by the consequent escape of the larger number of incomes from taxation. Some of the privileges accorded to incomes from special sources, such as building associations, rested on no very solid ground, while the taxation of all corporate dividends might have proved a hardship to those whose incomes, however small, were derived from such sources. The inclusion of inherited personal estate as income for the year in which the property fell to the heir was an unwise attempt to seize upon a source of income best left to the commonwealths.

It would be an unprofitable task to inquire whether the considerations in favor of the measure outweighed those advanced against it. Many who thought the tax hopelessly defective from an administrative standpoint regretted the decision of the Supreme Court, for fear that in case of war we should be deprived of an almost indispensable fiscal agency. But it is not certain that the war spirit may not in future so far penetrate that court as to lead it to revoke a decision which came as such a surprise in times of peace. Though we may not finally be able to do without an income tax, we could hardly have acquiesced permanently in such a tax as that of 1894.

The Income Tax Decision. — The decision or, more strictly, the decisions of the Supreme Court which killed

[1] Corporation bonds ought to be classed with their stock as income sources.

the Income Tax of 1894 made a great deal of history, and unmade, or, at all events, remade, a good deal of law. It certainly traversed legal expectation,[1] it jostled the doctrine of *stare decisis*, it contravened previous decisions, and it discredited a good many *dicta* which had already become 'blessed words' among authoritative text writers and accredited authorities on constitutional law.

The status of the case was as follows: A certain Mr. Pollock, a citizen of Massachusetts, owned stock in the Farmers' Loan and Trust Company, a New York corporation. Said Pollock requested the company not to disclose income or pay the tax *voluntarily* upon such part of its income, or its wards' incomes, as might be derived from land or rentals, or from state or municipal bonds. The Farmers' Loan and Trust Company declined to accede to this request, and prepared to disclose and pay taxes on incomes derived from the sources above specified. Thereupon said Pollock brought suit in the Circuit Court of the United States for the Southern District of New York, and prayed for equitable relief, asking that the Farmers' Loan and Trust Company, in accordance with his request, be restrained from complying voluntarily with the income tax law, which he asserted was unconstitutional. That corporation in its *demurrer* waived the point of adequate remedy at law as by *mandamus*,[2] cited want of equity, and maintained the con-

[1] I do not make this statement entirely upon my own authority. While the decision was pending, I was told by the dean of one of the largest law schools of New York City that the metropolitan bar expected the court to uphold the constitutionality of the law.

[2] Equity cannot be invoked so long as there is an adequate remedy at law, but a *mandamus*, if issued, could have required the corporation to pay under protest. The Revised Statutes (§ 3224) prohibit federal courts from entertaining suits for stopping the assessment or collection of taxes.

stitutionality of the law. The case was dismissed by the Circuit Court on *demurrer*, and thereafter, as involving the constitutionality of a federal statute, was appealed to the Supreme Court. First, in March, the case was argued by a distinguished array of counsel before that body, which handed down its first decision April 8, 1895, and, after a rehearing before a full bench, its final decision in the following May. The appellant's contentions were essentially these: (1) that the law was unconstitutional because it taxed rentals; this, he alleged, was essentially a tax on real estate, which was a direct tax and as such contravened the fourth clause of Section 9 (Article I) of the Constitution, which provides that direct taxes shall be laid "in proportion to the census or enumeration" therein provided for. The law, it was contended, violated also the third clause of Section 2 (Article I), which decrees that "direct taxes shall be apportioned among the several states . . . according to their respective numbers," etc. It was claimed (2) that the law was unconstitutional because it taxed income from personal property; this also, it was contended, was essentially a direct tax, and thus contravened the same constitutional provisions. Moreover, the allegation was made (3) that the law was unconstitutional because, even if not a direct tax, it was repugnant to the first clause of Section 8 (Article I), which provides that "all duties, imposts, and excises shall be uniform throughout the United States" (the "uniform" requirement, it was alleged, was sinned against by the $4000 exemption and the exemption of certain specified classes of incomes). Lastly it was contended (4) that the law was unconstitutional and void because the tax imposed on incomes derived from state and municipal bonds was an unwarrantable transgression upon powers reserved

to the states in Articles IV and V of the Constitution.[1]

The last contention was practically conceded by the government and may be dismissed without comment. Such incomes as thus escaped the income tax would have lessened the aggregate yield of the tax to no very damaging extent. The third contention, that of lack of "uniformity," finally hinged upon the construction put on the two prior contentions. The uniformity required by the Constitution had been generally interpreted as a mere geographical uniformity. If the indirect effect of the law was to tax certain sections, notably the northeastern, more severely than the others, it would seem to follow that import duties imposed on goods mainly or wholly consumed in certain sections are unconstitutional. But this was not the pivotal point of the battle. The point which the assailants of the law chiefly attacked was *the direct nature of the tax*. Boiled down, the argument against the law was this: the income tax is a direct tax; it is not apportioned to population, as the Constitution provides direct taxes must be; it is therefore unconstitutional and void. Perhaps never before was a phrase more twisted than the phrase "direct taxation." The most desperate attempts were made to discover some definite and consistent meaning that must inevitably attach to the term direct tax.

It is one of the costs of a peaceful civilization ruled by courts of justice, that grave issues sometimes take a shape which the traditional "visitor from Mars" would find hard to view with any measurable amount of gravity. Here were two sections of a nation, each trying to unload on

[1] Neither Congress nor the states may tax an official agency of the other. To allow this, if the nominal tax were exorbitant, would destroy or weaken the autonomy of the federal government or that of the states.

the other a burden of taxation, and the issue was finally to turn on the interpretation of a single phrase. It is sometimes lucky, however, that a nation can afford to seem ridiculous. It is cheaper than fighting, and by far more comfortable.

At the first hearing of the case the Attorney-General, Mr. Olney, in behalf of the government, was inclined to treat the contention that the income tax was a direct tax (in the constitutional sense of the term) rather cavalierly. He declared that "whether an income tax is what the Constitution describes as a 'direct tax' is a question as completely concluded by repeated adjudications as any question can be. It is not a direct tax within the meaning of the Constitution, unless five concurring judgments of the Supreme Court have all been erroneous." This was unquestionably the view of most authorities on constitutional law. Judge Cooley in his work on The Law of Taxation (p. 8) had explained the phrase as follows:

"Question has several times been made as to the meaning of the term direct taxes as thus employed. It was held in an early case that a tax on carriages, by number, was not a direct tax in the sense of the Constitution, and it was strongly intimated in the same case that only capitation taxes and taxes on land should be deemed within the provision. More recently it has been decided that a tax on incomes is not a direct tax. Neither is a tax of a specified per cent. upon the circulation of banks; nor a tax upon succession to realty on the death of its owner. And the intimation of the earliest case is very distinctly affirmed in one more recently decided where a tax on land was in question."[1] What

[1] The cases referred to in their order are: (1) Hylton *vs.* U. S., 3 Dall. 171; (2) Pacific Insurance Company *vs.* Soule, 7

the meaning of the phrase "direct taxes" was in the constitutional convention can only be surmised. Probably, like most other terms whose content has not been subjected to minute scrutiny, it meant one thing to one member, another to another, and nothing at all to a third. Madison has recorded that "in the course of the debates, and after the motion of Mr. Ellsworth that the first census be taken in three years after the meeting of Congress had been adopted, Mr. King asked what was the precise meaning of direct taxation," and added significantly, "No one answered."

The first tentative answer came in 1796, when the Supreme Court, some of whose members had been also members of the constitutional convention, decided the case of Hylton *vs.* U. S. and expressed the opinion *obiter* that only land taxes and capitation taxes were direct taxes in the constitutional sense of the term. The war income tax had also been tested before the Supreme Court, which decided, *In re* Pacific Insurance Company *vs.* Soule, that a tax on the income of an insurance company was not a direct tax, and, *In re* Springer *vs.* U. S., that an income tax was not a direct tax, though here it was urged that the income sprang in part from land. Indeed, both sides, in 1895, were agreed that a land tax was a direct tax in the view of the Constitution, but the government contended that, to constitute a land tax, land must be taxed immediately by quantity or valuation, while the appellants declared that a tax on *income derived from land* was a land tax and therefore a direct tax. The latter was the view which the court by a narrow majority adopted. "The name of the tax," said Chief Justice Fuller, "is unim-

Wall. 443; (3) Veazie Bank *vs.* Fenno, 8 Wall. 533; (4) Sholey *vs.* Rew, 23 Wall. 331; (5) Springer *vs.* U. S., 102 U. S. 586.

portant. The real question is, is there any basis on which to rest the contention that real estate belongs to one of the two great classes of taxes, and that the rent or income which is an incident of its ownership belongs to the other ? We are unable to perceive any ground for the alleged distinction." All that a layman can say in answer to this way of putting the case is that if lawyers are universally to begin to lay aside all verbal distinctions which enshrine precedents and no longer follow their ancestral wont of discriminating between the temple and the gold of the temple, the altar and the gift thereupon, there is a large amount of law which is in a pretty "parlous" state.

Mr. Justice White's dissenting opinion commended itself to the judgment of more than one jurist of repute. "Here, then," says he, "is the dilemma: if the framers [of the Constitution] understood the meaning of the word direct, the practical effect which they gave to it should remain undisturbed; if they were in doubt as to its meaning, the interpretation long since authoritatively affixed to it should be upheld. . . . The opinions in the Hylton case, so often approved and reiterated, the unanimous view of the text writers, all show that a tax to be direct must be an assessment of the land itself, either by quantity or valuation. Here there is no such assessment." At the first hearing of the case eight justices sat *in banco*. They declared the tax on incomes derived from rent and from state bonds unconstitutional, and divided evenly on the issue of the constitutionality of taxing other incomes. When the case was reheard before a full bench of nine justices the constitutionality of the tax on all sources of income was denied, inasmuch as the prior elimination of the tax on rent in-

comes had, in the opinion of the majority of the court, fatally destroyed the original intent of the law.

The deliverance of the court can be explained only by reference to what has been happily termed "psychological climate." No one, in his senses, dreamt of impugning the scrupulous honesty of our highest judicial tribunal. Still, there were but few who had expected a decision which ran in the teeth of dicta and precedents, and the effect produced, even upon those who personally had every reason for detesting the tax, was that of surprise, none the less intense because very welcome. The Supreme Court had reversed its own decision before, but except in the legal tender cases no modern decision had been reversed which bore very directly upon the stirring political issues of the day. But the court evidently had not been appealed to in vain upon the issue that the tax was a stride towards socialism, and the "weightier matters of the law" seemed to have been forgotten under the shadowy sense of dread which the dim spectre of socialism invoked. The most venerable member of the court gave emphatic utterance to the feeling which moved him. "The present assault upon capital," said Mr. Justice Field, "is but the beginning. It will be but the stepping-stone to other, larger and more sweeping, till our political contests will become a war of the poor against the rich, a war constantly growing in intensity and bitterness." Whether the prophecy come true or not, it is at least open to question whether the decision, like the famous Dred Scott decision, may not contribute to bring about the very end it sought so sedulously to avoid.

CHAPTER IX.

PUBLIC INCOME FROM QUASI-ECONOMIC SOURCES.

The Contractual Income of the State.—It is not alone through the drastic agency of positive law which always stands behind the tax collector that the entire income of the state is obtained. Alongside the state as a master, stands the state as a business agency; and though no two characters may seem less compatible than those of "sovereign" and "trader," no state confines itself exclusively to either. Just as an individual derives his income from his property or his labor, so the government supplements its income from taxation by such receipts as it may obtain for the use of public property or for the performance of public services. The public lands figure among the resources for meeting public expenditure, and the charges for postal services remind us daily that not all we pay into the coffers of the public treasury stands itemized on our tax duplicate. The quasi-economic income of the state, then, will comprise such revenues as accrue to the fisc from all sources except taxation; and as such receipts very generally presuppose a contract, specific or implied, between the state and a private party, we may lump these receipts under the head of "contractual income."[1]

[1] The subdivision of public income into two great categories, tax income and contractual or quasi-economic income, has many

Looked at broadly, the contractual income of the state invites a double treatment, partly descriptive, partly controversial. There are certain fields of economic activity, such as the post-office, which custom has, as it were, consecrated to government administration. Where the state through long experience has become a fairly efficient industrial agent, the task of the financier is practically narrowed to scanning with discrimination such sources of public income and testing the principles upon which they are based.

There are, on the other hand, certain enterprises under private management, notably the business of transportation in the United States, where the evils resulting from the absence of ordinary competition are alleged to require the extension of the state's industrial functions. Where economic considerations of public policy are

advantages; and considering the scope of this work, where financial categories *non sunt multiplicanda*, is all but inevitable. The criteria distinguishing the two are: (1) the machinery of collection; (2) the somewhat voluntary character of contractual income; and (3) the cost of collecting the two respectively. Quasi-economic income is generally collected by administrative agents distinct from the ordinary revenue or tax officials. The time of the payment of contractual income is to a certain extent at the option of the payer, though this is also true with reference to indirect taxes. The ratio of gross receipts to net receipts is almost always greater in the case of quasi-economic income than the ratio of the total amount of taxes collected to the net yield of taxes after the cost of their collection has been deducted. Seligman's acute distinctions between taxes, fees, and prices (p. 302 *sq.* Essays in Taxation) would involve a splitting up of income from the same source to such an extent as to make necessary a very intricate arrangement of public income sources,—a point well urged by Bastable (Public Finance, 2d ed., p. 153 *sq.*, note). Special assessments are, in this work, subsumed under taxes though differentiated from taxes in the ordinary sense. It is frankly admitted that certain minor public receipts, such as registration fees and penal fines, do not easily fall under either taxes or contractual revenue. Such receipts, however, are insignificant in amount.

raised, which if well founded would necessitate an enlargement of the contractual income of the state, the preliminary economic issue must first be disposed of before the financial problem can well be attacked. Accordingly, we shall first review the existing sources of the state's quasi-economic income, and thereafter proceed to the question of investing the sovereign with enhanced industrial powers and duties.

Extant Sources of Contractual Income.—(*a*) *Public Land.*—Almost all states still hold title to certain lands from whose rental or sale they derive a certain amount of income. Whether there was ever a time when all land was held in common or tribal ownership is a vexed historical problem, but certain it is that in all countries, with the progress of civilization, the public lands have tended more and more to pass into private possession. Bastable cites the great public acreage of Russia to illustrate "the statement that the less the development of the society the greater is the proportion of public land"; and draws the evident conclusion that "the function of the state as owner of agricultural land is sure to decline in importance with the advance of society."[1] This fact points to one of the sharpest contrasts between feudal times and the present era,[2] and the extension of private holdings at the expense of the public domain bears significant witness to the increased economic strength imparted to the state by the more careful and efficient cultivation which private property in land has induced. The recent movement for the nationalization of land by the absorption of land rent through taxation, whatever be its eventual outcome, is certainly an attempt to row against the stream of modern tendency. City growth

[1] Public Finance, p. 169 and p. 168.
[2] See p. 16.

and the parallel increase in urban rents, however, have induced some financiers (e.g. Wagner) to view with favor the municipal acquisition of suburban districts, while others think the retention of building sites when they are already in public ownership the readiest solution of the problem of taxing ground rents.[1] The whole question of the single tax on land rentals is treated elsewhere, and need not be considered here.

The public domain in the United States has had an historical significance that can hardly be underrated. Between the states whose perfect union was at first only sketched in the federal constitution the public lands created the unifying tie of a common interest in a future empire. The germ of nationality was to ripen with the settlement and the domination of those vast tracts which lay west of the Alleghanies to the Pacific. It was therefore wise prevision, pregnant with import, that led the nation speedily to open up this territory to settlers whose acquisition of land in fee simple was made almost without money and without price. So, too, to-day in the matter of the public lands, the exhaustion of the available arable area, the irrigation of arid soils, the quashing of invalid titles, are issues of telling moment.[2] But it is largely because our *ager publicus* has been of such transcendent political and economic import that its financial significance has been trifling; for when to the cost of acquisition of Indian and foreign titles there is added the cost of government surveys, it turns out that the public lands have proved a net drain upon the federal treasury.[3]

[1] Bastable, Public Finance, p. 178.

[2] Cf. Hart, Practical Essays on American Government, Essay X; also published in the Quarterly Journal of Economics, Vol. I.

[3] Prof. Hart's computation (*op. cit.*) of the aggregate expense of public lands to the federal treasury ought to be offset by the

Less than one per cent. of the ordinary revenue of the national government is at present derived from the annual sales of public land,[1] and but a trifle over three per cent. of the commonwealth's receipts flows from the public lands they hold.[2] There is almost universal acquiescence in the advisability of alienating the public domain, provided always that it be turned over to *bona fide* cultivators and not to syndicates of speculators. To pursue another policy would imply the public exploitation of the domain or an involved policy of leasing the public lands to individuals. The stimulus of self-interest would be lacking in the first, and the risks of speculation would be present in the second. Besides, as Adam Smith urged, if the public domain, when sold, would cancel the public debt in whole or part, a virtual mortgage on the public income could be lifted and the expense of the public administration of the domain could be abolished. When, moreover, it is notorious that in agriculture the force of competition is so very apt to insure fair prices, and that the public management of lands has proved scandalously ineffective, the argument for the alienation of public lands available for farms seems conclusive.[3] There are, however, certain dissentient voices raised when the sale of mines and forests

income derived from public lands bestowed upon the states and used by them as a source of income for educational and other purposes.

[1] The net federal income for the fiscal year 1897-8 was $405,321,335, of which $1,243,129 came from land sales.

[2] Cf. State Library Bulletin of the State of New York (Legislation, No. 8). Public lands netted the commonwealths in 1890 $5,784,770; in 1895, $3,796,103. The total receipts for the years in question are $111,195,003 and $124,925,920.

[3] Thorold Rogers asserts that the waste incurred in the management of Crown lands in Great Britain is "enormous and scandalous." See his note in his edition of the Wealth of Nations, Vol. II., p. 413.

lying on the public estate is proposed. The exhaustion of the nation's stock of metal and timber, which the ruthless exploitation of such property by private owners would bring about, is urged against the transfer of these tracts to individual ownership. The speculative character of mining, however, seems to fortify the other reasons that may generally be uged against the public prosecution of industrial ventures, but a strong case may be made out for the public retention of forest land and its administration by a competent official staff. Individual self-interest can be trusted to supply lumber from extant forests, if the price for lumber will warrant, but the process of re-afforesting requires such a length of time that self-interest cannot be trusted to re-create the material which it has destroyed. Moreover, it is urged that the denudation of forest land causes or aggravates inundations and floods, and thus indirectly destroys property and involves expenditure for levees and similar protective works. Even the climate is said to be modified—generally for the worse—by the devastation of woodlands. These reasons presumably justify the state's retention of a certain amount of forest land, but the net money income from such land will probably be inconsiderable.[1]

(*b*) *Public Industries.* — Public industrial enterprises have varied in number and extent from time to time, as at present they vary from nation to nation. The maintenance of ordinary roads and systems of drainage

[1] A little healthy skepticism with reference to the climatic influences of forest devastation may legitimately be indulged in. Cf. Schoenberg, Handbuch, Bd. 3, p. 68. Moreover, it may be observed *passim* that the preservation of the forest land in the United States is not materially advanced by putting a duty on the importation of foreign timber, and thus incidentally a premium on the annihilation of our own forests.

which are now almost everywhere included among the proper and gratuitous tasks of the government was once a business venture often taken up by private individuals or companies for private profit. So to-day we find a great contrast between states and municipalities in respect of the industrial undertakings they respectively assume. At one extreme stands the Prussian kingdom, owning and operating its railroads, telegraphs and telephones, and in great part managing its mines and forests, to say nothing of its porcelain factories and other miscellaneous government plants. Our own federal government, on the other hand, modestly confines itself, so far as business hazards are concerned, to the administration of the post-office. Great Britain has acquired its telegraph system by purchase from the pre-existing private companies, and manages it in conjunction with the post. The Australian colonies alone among English-speaking peoples own their railroad system and operate it through their public functionaries, while in France we find under state direction the entire manufacture of tobacco no less than the fabrication of such articles of *vertu* as Sèvres ware and Gobelin tapestries. Almost all governments maintain certain public works, such as dockyards for the equipment of their marine, while public armories and gun-factories are found everywhere in connection with the preparation of armament or war material. Municipalities differ *inter se* no less than central governments in regard to their public industries. The municipality of Birmingham, so we are assured, furnishes the citizen with light, conveyance, literature—almost everything he could desire; while many of our newer municipalities apparently rest satisfied when once they have furnished the citizen with "freedom to worship God." The public ownership and operation of water-

works, of gas and electric plants, and of surface roads is very frequently found on the Continent and in England, while our American cities, with but few exceptions, have undertaken none of these ventures except that of water-supply. As our primary task, however, is one of description, we may begin with the consideration of the post-office and of public waterworks, almost the only industrial enterprises carried on in America by the federal and local governments respectively.

Of all the caprices of nomenclature, none is more singular than the bequeathing of the martial term "post" to that big industrial machine which more than any other binds the world of to-day in the peaceful ties of friendship and commerce. It is much as though by some curious accident the word frontier had become the peculiar designation of peace congresses or arbitration conventions. But nevertheless the fact is that the post in its original form was an organization for hastily sending military orders between the centre and the confines of the feudal state. It was only after swords began to give way to plowshares that this bureau for the transmission of military intelligence gradually took on the functions, first, of forwarding private persons, and then their letters and packets, from one part of the country to another. As industry and commerce grew, this business became lucrative. It was farmed out to private individuals or to corporations; in France to the University of Paris, which paid annually for this monopoly privilege a round ransom to the coffers of the state. Finally, it was operated directly by the state, and has in some countries taken to itself the cognate undertakings of forwarding telegraphic and telephonic messages, of expressing parcels of moderate size and weight, of transmitting money, and of serving as a public savings bank

and insurance agency. Everywhere it is a government monopoly, and almost everywhere the government management is efficient and generally satisfactory. This last circumstance alone would be sufficient to suggest an inquiry into the nature of the business, for if the post-office is to be taken without dispute as an exemplar of state industrial administration, state socialism will be upon us to-morrow.

The post-office, upon investigation, proves to be unique in more ways than one. The risks involved in the ordinary processes of trade and manufactures are wholly absent. The system of transportation of which it avails itself is ready to its hand. "It has made use of existing and well-known agencies, where the only difficulty was one of organization," says Lord Farrer, who adds: "It is a merit of the undertaking, regarded as an official institution, that there is very little of that speculative element about it which is the life-blood of commercial activity."[1] The capital which the state is required to furnish is comparatively small in amount. Even in private concerns, while the interest on invested capital must be covered if the business is to prove a paying one, there is frequently too little allowance made for the depreciation of fixed capital. Where the state furnishes the capital for an enterprise the interest on the investment is frequently forgotten when the industry's profitableness is gauged, and so far as depreciation of state owned capital is concerned, there is little official disposition to worry about that. *Après nous le déluge* is the comfortable solace of the department, as the taxpayer finally learns to his cost. Again, the post-office is kept under the constant espionage of the public, who can

[1] The State in its Relation to Trade, p. 107.

check its efficiency by railway time-tables, and note and complain of the slightest mismanagement. Even the matter of postal charges is comparatively simple. Nor does the simplicity wholly consist, as we might at first blush imagine, in the purely arbitrary uniformity of postal charges irrespective of the distance traversed by the letter or package. Nothing seems more transparently artificial than to make the same charge for carrying a letter from New York to Brooklyn as for carrying a letter from Maine to California. But underlying this seemingly incongruous postal tariff is the indubitable fact that this uniform rate is perhaps as nearly proportional to actual cost as any other (within decently moderate limits) which could be framed. That great public benefactor, Sir Rowland Hill, to whom England and the world owe their systems of cheap and uniform postal charges, demonstrated as early as 1837 that the expense of collection, sorting, superintendence, and delivery (which were essentially the same for each and every letter) far outweighed the varying expenses incurred in the mere transmission of letters from place to place.[1] A uniform postal tariff, therefore, is not only convenient so far as it obviates difficulty and uncertainty on the part of the postal officials, but is likewise dictated in part by the underlying expense involved in the process. This fact of itself is sufficient to separate *toto cœlo* the question of postal rates on the one hand and railway charges on the other. The really arbitrary factor in the matter of postal rates is not so much the uniform charge irrespective of distance, as the division

[1] Cf. Jevons, Methods of Social Reform, p. 369. The conditions in the United States are widely different from those prevailing in England in 1837. In the fiscal year 1897-8 the amount paid for the transportation of the mails was $51,780,283; for postmaster's services, $17,460,621.

of mail matter into various "classes," and the arbitrary fixation of rates for those different classes. We find in the United States that while the carriage and delivery of mail matter of the first class alone might seem profitable, the loss involved on matter of the second and lower classes is sufficient to produce a net postal deficit. Still, public opinion would not tolerate an increase in letter postage, and to raise rates considerably on second, third, and fourth class matter would probably reduce the present volume of mail carried. There seems no very good reason, however, why higher charges should not be imposed on second class matter so as to avoid the annual postal deficit. It must be remembered that the postal officials are not charged with this business of classifying mail matter. The classes are strictly defined by law, and the department has simply to obey instructions which, after all, are exceedingly simple. Add, finally, to the other peculiar characteristics of the post-office this, that an increase in its volume of business does not ordinarily involve a corresponding increase in its working expenses, and that the great postal reforms and improvements have as often been forced upon the department from outside as they have originated within its own official circle, and we are in a position to understand why, as Adam Smith says, it is "the only mercantile project which has been successfully managed by . . . every sort of government." [1] Where other enterprises call for venturesome and speculative activity, the post-office requires orderly routine; where the former demand much fixed capital, the post needs comparatively little; where in ordinary business transactions prices vary even for the same service, the post-office has al-

[1] Wealth of Nations, Book V., Chap. II. (p. 405 of Vol. II., *Thorold Rogers' edition*).

ways one price for the same service; where other industrial enterprises, if mismanaged, long escape exposure and protest, the Argus-eyed public is daily inspecting the efficiency of the postal service; where the freight agent is puzzling over a complicated railway tariff, the postal clerk has the same simple regulations to guide him to-day and to-morrow. Under such circumstances the government's successful administration of the post-office can hardly be construed as proving that the government can profitably acquire and capably administer other industrial enterprises. The admittedly successful management of the post-office must not be understood to imply that it is uniformly self-supporting. "England, France, and Germany are the only countries that derive a substantial amount [of money revenue] from the postal service."[1] The post-office in the United States, with the exception of two years, has not "paid its way" since 1865, and the ordinary deficit which now has to be met by appropriation is almost $10,000,000 a year.[2] Thus in the department for the fiscal years

1895-6	the revenue was	$82,499,208;	expenditure	$90,626,296
1896-7	" " "	$82,665,462;	"	$94,077,242
1897-8	" " "	$89,012,618;	"	$98,033,523

Obviously, where the state monopolizes an industry, it may set such prices as net the maximum revenue, or such prices as yield a fair profit, or such as will simply cover cost. It may also render products or services gratuitously and charge the expense upon the proceeds

[1] Bastable, Public Finance, p. 194.

[2] In 1882-3 and 1883-4 the post office yielded a minimum net income (no allowances being made for depreciation of postal property). The subsequent reduction of letter postage from 3 to 2 cents led to steady deficits thereafter.

of taxation. In a democratic state, however, two tendencies are almost always at work when the government enters the industrial field. One is a popular clamor for low prices, and the other is popular indifference to financial deficits which these low prices when accorded tend to produce. Both tendencies showed themselves in England in the matter of government telegraphs; both are in operation in the United States in regard to postal charges. There is almost every reason to believe that a uniform letter charge of one cent an ounce would largely increase the annual postal deficit, and there is very little reason to think that a deficit so produced would occasion any solicitude on the part of the public. It is all well enough theoretically to discuss which policy the state ought to pursue in fixing its charges,—whether monopoly profits or fair profits, or cost, or gratuitous service should be the rule,—but the fact is, as stated above, that democratic sentiment will incline toward the cost or gratuity principle. Consequently, if it is a good rule that (except where services are of universal utility, such as police protection or justice) the one who enjoys the music, and not the taxpayers generally, should pay the fiddler, there is, in view of this tendency of democratic finance, additional reason for limiting the state's industrial functions to their narrowest practicable limit.

The business of carrying and delivering the mails was, as we have seen, an enterprise designed originally for military and administrative purposes. When changed industrial conditions had rendered it chiefly an instrument of commerce, the state administration continued. The peculiar character of the undertaking, moreover, proved specially adapted to such public management, and thus the state's monopoly of the post is, in a sense,

an historical accident. Very different is the story of the government's acquisition and monopoly of industries of more recent origin. Especially in the case of local governments has such action been due to the rapid growth of concerns which from their nature are aliens to the commonwealth of competition. Prominent among such industries are the so-called "natural monopolies" engaged in supplying water, light, and local transportation. Characteristic of these typical monopolies are the economy which results from their unified organization and operation; their large exclusion of competition by reason of the general inconvenience which must result from tearing up streets or cumbering their surface with parallel competing lines of pipe, track, or wire; and, lastly, the indispensable nature of the services which these monopolies render to the increasing part of our population which dwells in cities. The "municipalization" of these natural monopolies has gone farther in the Old World than in the United States, but we have made a beginning of erecting and operating public waterworks in most of our larger cities. Unquestionably, too, we have begun at the right end. The article supplied is one of prime and permanent necessity. The technical apparatus has been brought to a high degree of perfection, and the engineering work required for the construction of reservoirs and the placement of mains embodies no particular mystery. The capital expenditure, while enormous in the aggregate,[1] is not prohibitory or excessive for each city or town. The management of the business involves no risk and little peculiar difficulty. Responsibility for inefficiency is quickly

[1] The census of 1890 estimates local debts contracted for waterworks at about $192,000,000.

brought home in the small areas of local government; and the rates charged consumers, while they vary from place to place, ought generally to cover the expense of operation, the interest on the capital invested, with an additional margin for the maintenance of the plant and the ultimate extinction of the bonded indebtedness incurred to establish the works. Still, if the water rate is reduced below cost, the very general utility of the commodity supplied may serve to cloak or palliate the departure from the sound rule of finance above enunciated. No municipality can be expected to be devoid of all idiosyncrasies, and that city is fortunate which errs from the strict path of financial duty only in the matter of refusing to put "a tax on cleanliness."

In addition to the two typical industries, the post-office and public waterworks, managed respectively by the federal and local governments, passing mention must here be made of several additional business ventures under public management in the United States. Several cities [1] have instituted or acquired plants for furnishing illuminating gas, and many more have public electric light plants. There are a few tentative instances of municipal street railroads, while markets, bridges, wharves, docks, and harbors have for a longer time been under municipal management. The advisability of such undertakings will come up later for discussion. Both the federal and local governments are the recipients of penal fines and of registry fees and other miscellaneous fees. The federal government, moreover, has an additional source of profit in the seigniorage charge made upon subsidiary coin. The bonds issued in 1862 and

[1] Philadelphia was for a long time the standing example of a large city owning and operating its own gas plant. The property has recently been leased to a private company, however.

1864 to aid in the building of the Pacific railroads [1] represent the only extensive speculation in capital to which the federal government (and then largely for non-commercial reasons) has of late years committed itself. It is probable that the loans made to construct these roads will furnish little or no encouragement for another federal subsidy to similar commercial enterprises. Lastly, it must never be forgotten that in connection with its other work the federal treasury acts as a bank of issue. Whether any profits in the long run accrue from this source is a disputed question. The maintenance of a credit circulation largely in excess of its metallic reserve is held to imply that interest is saved on the uncovered circulation, and it is plausibly argued that interest saved is interest earned. At all events, whatever income, if any, is derived from the Treasury's banking business does not take the form of money income, and can only be estimated by considering how far, if at all, government banking makes the annual expenditure for interest on the public debt less than such interest would otherwise be. This question is reserved for examination in Part III.

To recapitulate, the contractual public income in the United States accrues mainly from the post-office and municipal waterworks. Both of these undertakings, it is almost universally conceded, are fit and proper subjects of government monopoly and management. Analogous

[1] The total amount of bonds issued to the Pacific roads was $64,623,512. The interest paid on these bonds had increased the railroads' indebtedness to the government by $71,097,610 on November 1, 1893. This debt has been partly repaid, and arrangements have been concluded for the repayment of the residue outstanding, both principal and interest, within ten years (from 1899), excepting only the interest on about $6,000,000 advanced to the Kansas Pacific Railroad.

enterprises are in other countries under state control. How far the extension of such governmental industry is advisable in this country remains to be considered. But even though the limits of public industry eventually be widened, there is little reason for believing that the net income which they will furnish the public chest will approximate the much greater revenue collected through the agency of taxation.

CHAPTER X.

EXTENSION OF THE STATE'S CONTRACTUAL INCOME.

General Features of Railway Development.—So long as we confine our discussion to the depiction of the successful administration of the post and of waterworks by governmental agency, our task is irenical. When we trench upon the question of extending the industrial sphere of the government, controversy at once grows rife. To transport ourselves into the midst of the fray it is only necessary to begin with "the railroad problem." This well-worn phrase serves as a label for many issues. For there are a thousand railroad problems, or rather a thousand different aspects of the same problem, which daily confront us. Ask the investor to define the problem, and he will tell you it is the maintenance of dividends and interest payments on railroad securities. Ask the traffic manager, and you will learn that the railroad problem which confronts him is to increase the volume of his road's traffic. The shipper is equally sure that low freight rates are "the one thing needful" for all alike, and a special rate or rebate most necessary for himself in particular. The socialist, on the other hand, regards all these answers as distressingly inadequate, and thinks to see the solution of the real problem in the elimination of the element of private profit, and in the diffusion of economic advantage which

he thinks must result from state ownership and operation of our railway systems. It is this last contention which will immediately concern us, for should it be substantiated, the financier must make up his mind to the public acquisition of railroads, and to an incredibly vast enlargement of the state's industrial domain, of its annual expenditures and its annual income from quasi-economic sources. Evidently the discussion of so momentous an innovation will require a preliminary glance at the salient features of railway development.

It is hard for us to realize vividly the condition of economic society before the era of steam transportation. We look to-day at the map with eyes grown accustomed to the criss-cross and zigzag of railroad lines. Our notion of the distance from New York to Boston, for example, is an estimate of the time consumed and the discomfiture entailed by so many hours on a moving platform, and it requires a rather violent jogging of the imagination to conjure up a picture of that utter isolation which was relieved only at intervals by the stage-coach and the mounted messenger. It is not surprising, therefore, that the generation which witnessed the inception of steam railroads should have failed miserably to form any true conception of the nature and importance of this new and revolutionary agency. They made no pretensions to being prophets, and even if they had, it was questionable whether their boldest flights would have been such as to outwing the railway achievements which we regard to-day as commonplace matter-of-fact. The view first taken of railroads was, very naturally, that which was most easily deduced from the supposed analogy of railroads to public highways. The received dicta of the economists upon trade and industry in general were supposed to apply rigorously to railways. How

slowly the real nature of railway transportation was apprehended may be judged from some of the popular ideas current between 1830 and 1840. It was in the year first mentioned that the first English railway, that from Liverpool to Manchester, was completed. In 1836 there was published by Henry Fairbairn a treatise entitled "The Political Economy of Railroads," which was not merely representative of the advanced thought of his age on the subject, but which was fully abreast of expert opinion as well. Fairbairn, who was a man of no mean penetration, argued in the manner of Adam Smith that roads operated by private individuals were likely to be superior to those managed by joint-stock companies; that free competition in railroading was the certain guarantee of conforming rates to the cost of service; he asserted that "the cost of transportation by steam is so very expensive that little merchandise is carried upon the railroad," and that "horse-power, in the present state of our knowledge of the principles of motion, is, therefore, much cheaper than any of which we are possessed." Canals he scouted as among the "rude inventions of a former age." It was popularly supposed at first that railway carriages and locomotive engines would be owned by individuals, and would be used upon the iron highways as the personal convenience of the owners might dictate. It is enough to humble the presumptuous forecast of the economist to mark how a man of Fairbairn's perspicuity was led to set up a series of propositions about railroad economics every one of which experience has flatly reversed. The railway corporation has entirely displaced the private railway company; rates are based on almost everything but cost of service; and, most important of all, freight traffic has attained such a magnitude that it entirely dwarfs the transportation of

passengers, and furnishes roads with nearly four fifths of their earnings.

Railroad building, however, progressed in utter unconcern of the *à priori* speculations of the economists. The wonderful growth in railway mileage in Europe and America is too well known to require more than passing mention here, and time itself would fail to tell of the innumerable improvements in engineering, appliances, speed, safety, and comfort which are all combined in the world's railroad systems of the present.[1]

This astounding development of a new system of highways equipped with every appliance for the speedy transportation of passengers and freight would have proved universally acceptable had not the economic organization of railroads and their rate sheets given grave cause for concern. A network of superior toll pikes, each for a few miles under the control of a toll pike company, which was bound to meet the competition of hundreds of similar companies, and thus under compulsion to exact only reasonable charges, presented no very alarming prospect in the early days of railroad building. It took years, in some cases even decades, for the citizen to real-

[1] To get an idea of the growth of railroads, it may be well to remember that it was in 1829 that the first line was constructed in the United States. Poor's Manual for 1897 gives the following figures for the railroads in the United States for 1896:

Miles of railroad operated	180,891
Tons of freight moved	773,868,716
Freight mileage	93,885,853,634
Passengers carried	535,120,756
Passenger mileage	13,044,840,243
Earnings from freight	$770,424,013
Earnings from passengers	$265,313,258
Miscellaneous earnings	$89,894,754
Total gross earnings	$1,125,632,025
Net earnings	$332,333,756
Earnings per ton-mile	0.821 cents

ize the fact that in abetting the liberal construction of railways he had created an industry which was likely to prove not his servant but his master. Even those publicists who had stood sponsors to the infant industry were appalled to see it speedily develop traits of monopoly, extortion, and unabashed favoritism.

In the first place the tendency to consolidation became unmistakable. The first railroads were in length very similar to our trolley roads to-day. The average length of early English lines was about fifteen miles. Very naturally short lines having one terminus in common became united under a single management. Expenses were reduced thereby, and transportation facilities, especially for through shipments, were enhanced. "If we follow back the history of almost any railway in the United States, we find the same tendency illustrated. The line of the New York Central between the Hudson and Lake Erie alone represents the union of what was originally sixteen different companies."[1] In England in 1847, with over five thousand miles of rail, there were several hundred companies. Twenty-five years later, with a mileage of thirteen thousand, the entire control was virtually in the hands of a dozen companies.[1] The same tendency showed itself in France and on the Continent generally, while the movement has gone so far in the United States that the Statistician of the Interstate Commerce Commission declares that at present "over 83 per cent. of the business and 82 per cent. of the earnings [of railroads] fall under the control of less than forty associations of business men." Thus out of hundreds of short, disconnected links there have been forged by consolidation those gigantic chains of rail which to-

[1] Hadley, Railroad Transportation, p. 12.

day span the continent. The day of the independent road was brief. The era of the railway "system" succeeded. The importance of through traffic was partly cause and partly effect of the tendency that made for consolidation. The short cross-roads became feeders of the systems they adjoined, and in hundreds of cases by sale or lease were swallowed up in the greater organizations. The utter impossibility of competing with the railroad in the transportation of freight or passengers gave the companies a practical monopoly in cases where the shipper had no access to another line of railroad or to carriage by water. Instead of a new system of short, multitudinous pikes employing improved instruments of locomotion, and compelled by self-interest to ask only reasonable (i.e. competitive) tolls, the business community awoke to find itself parcelled out amongst a small number of monopolist carriers whose rates at many points were not in the slightest degree determined by competition.

It was this last consideration which came home most vividly to the public and the shipper. Some vague disquietude was felt unquestionably at the tendency towards consolidation. There were not wanting Cassandras to plague the quiet hour with their uncomfortable alternative: "The state must rule the railroads or the railroads will rule the state." Very likely, thought the shipper whose mind would revert to the very much more pertinent inquiry why he must pay more for freight than his competitor in X, or how he could get a rebate like his neighbor in Y. This absorption of little roads by big ones was all very dreadful, the farmer admitted, but these freight rates were a thousand times more intolerable. Not merely nor indeed mainly that they were too high, absolutely considered, but that they were so im-

possibly unfair as between himself and his competitors in the towns near by.

The ' manifest destiny ' of short railroad lines to amalgamate was no more indisputable than the tendency everywhere evident to fix rates for transportation upon principles which at first sight appeared most extraordinary. It had been assumed that carriers by rail would adjust their charges upon the basis of tolls, that is, upon the actual cost of service. This, it was supposed, would correspond roughly to the distance traversed. The railroad companies soon found that it was impossible in the first place to estimate the cost of specific shipments by rail, and in the second place that a tariff based upon a system of tolls was impossible of enforcement. The immense amount of capital invested in railroads requires that a great part of every road's earnings be applied to meeting the interest charges on the capital sunk. These fixed charges are practically the same whether the total traffic is great or small. The expense incurred in the actual movements of cars varies only within certain moderate limits. To move double the ordinary volume of freight does not begin to double the expenses of the carrier. To move a full train load costs little more than to move the same cars half full. Hence it is impossible to estimate even approximately the cost of any specific shipment.[1] What the carrier has to secure, if possible, is an aggregate revenue sufficient to meet fixed charges, pay operating expenses, and maintain unimpaired the condition of the railroad property. Even these requirements, it would seem, might be met by a system of tolls producing revenue enough in the aggregate to defray total expenses and to leave a margin for profit. But

[1] Cf. Ackworth's article on Railroad Rates, Economic Journal, Sept. 1897.

such an attempt to apportion total expenses among shippers charged severally in proportion to the distance traversed by their respective consignments is absolutely foiled by the unavoidable necessity imposed upon the carrier of meeting at certain points the competition of rivals by land or sea. The terminus of a railroad system is not infrequently a competitive point served by several railroads and often by steamship lines. To obtain traffic at such a point it is necessary to meet the competition which centres there. So long as the rates demanded at these points by shippers are barely enough to cover the additional movement charges the carrier is prompted to concede such rates. This means low rates for through traffic and low rates for other points on the same line where an intersecting road creates a competitive nucleus. At such points each carrier has to grant low rates or get no freight at all. But no such necessity exists at other points on his line where competition does not exist. Neither the imperious necessity of meeting competition nor still less the *à priori* idea of proportioning rates to distance traversed weighs in favor of according low rates to local, non-competitive traffic. The carrier argues with great plausibility that, hard as the discrimination seems against the local shipper, it is really the best result attainable under the circumstances. To lower all rates horizontally to the through traffic level would result in the bankruptcy of the roads and in the curtailment or abolition of transportation facilities for through traffic and local traffic alike. To raise the rates on through traffic to the level of local rates would be to sacrifice the through traffic altogether, and would necessitate the raising of local rates still higher. The local shipper was practically told that he was the unfortunate victim of circumstances, and that the exorbitant rates of

which he complained were "the inevitable result of universal laws, with which, if it were not impious, it were as hopeless to quarrel as with the law of gravitation." God and Nature, not the railway company, had discriminated against him. It is not our purpose at this point to sift the chaff from the wheat in these contentions. Suffice it to say that rates as they were at first made were not only not proportional to the distance traversed, but on local traffic were not infrequently higher, in certain instances six times higher,[1] than rates upon through traffic hauled a much longer distance over the same line. This necessity of making special rates for various points upon the carrier's line made his rate sheet, as may be easily conceived, a curious labyrinth. But these varying rates caused only the smallest part of his perplexities. Traffic managers soon discovered that the charges they could impose depended very largely on the *value* of the various articles they transported. A rate which the shipper would pay per car-load on manufactured woollen goods was absolutely prohibitory if charged on bulky articles like coal or lumber. Either coal must be hauled at rates far below those imposed on textiles or not hauled at all. If a special rate on coal, therefore, would suffice to cover the small additional expense of hauling additional cars, such rates were accorded. Freight therefore was classified on the complex basis of value, perishability, and similar considerations, and each class of freight had its own rate, to say nothing of special rates, such as grain or cattle rates, which were established on particular articles. The rate sheets had become a veritable "wilderness of single instances." In this hopeless position the traffic manager

[1] Lewis, National Consolidation of the Railways in the United States, p. 97.

was guided in the majority of cases by the rule of charging what the traffic would bear.[1] Even at non-competitive points, if a special rate would increase the volume of traffic and leave the least margin over operating expenses, the rate was generally accorded. These considerations will explain in a way the origin, the singular complexity, and the apparent anomalies of railroad rates. It is comical therefore to see the dismay of legislative commissions when they proceed to investigate the subject of railway charges. The witnesses, generally practical railroad agents, have inherited a volume of rates of whose origin they are hopelessly ignorant. They have made in the rate sheets a thousand empirical changes to meet concrete circumstances, and when summoned to explain the rationale of rate sheet construction, they develop such abnormal powers of obfuscation that the investigating Solons not infrequently leave the subject of their quest with a mystified resignation such as befits those who have confronted the unsearchable ways of an inscrutable Providence.

However disappointing may be the investigation of the origin of any particular rate sheet, the forces which have controlled the formation of such sheets in general are the necessity of meeting competition at certain points, of grading freight largely on the basis of value, and of earning by all these means sufficient in the long run to meet fixed charges, pay operating expenses, and leave a possible margin for dividends.[2] Rates, it is true,

[1] The two paramount considerations in fixing rates are: (1) the necessity of meeting competition; (2) the necessity of developing traffic. The first explains largely the low rates on through traffic; the second the tarification of goods, i.e. imposing on them what rates they can be made to pay without cutting down the volume of freight.

[2] "The rates are governed by the nature and extent of the traffic, the pressure of competition, either by water, by a rival

have often been made on grounds of purely arbitrary favoritism, either local or personal, but it can hardly be questioned that this has been a secondary rather than a primary factor in their creation. The extent to which these rate determining agencies have been effective has depended largely upon the varying conditions under which railway systems have developed in various countries. The forces above specified have had freest play in England and the United States, where we have relied on private and corporate initiative to build and develop our railway systems under the stress of competitive rivalry. The plan upon which the French railways were constructed, with several large independent systems all radiating from Paris, has served to release the French companies in large measure from the restraints of their mutual competition. The state railway system of Australia and Prussia has operated in a measure to uphold the system of tolls in those countries. But even here it has been necessary to make exceptions in the toll system where the competition of water-routes or foreign railroads was encountered. Moreover the universal adoption of schedules of classification for freight has proved that the principle of tolls, i.e. of basing rates exclusively on cost, is by itself impossible of application, whether upon state roads or private lines.

Government Regulation of Railroads in the United States.—In the very beginning of the railroad era there was a strong *à priori* presumption in favor of governmental control or ownership. A railroad after all was

railway route, or by other land carriage; but above all, the companies have regard to the commercial value of the commodity, and the rate it will bear, so as to admit of its being produced and sold in a competing market with a fair margin of profit."—The Working and Management of an English Railway, p. 264, by George Findlay.

only a new variety of public highway, fitted no doubt mainly, perhaps exclusively, for wagons of a certain gauge, offering exceptional advantages to the use of steam as a motive power, but still a highway. It did not at that early day smack of socialism to hold a brief for state railroads. Even Adam Smith found it entirely consistent with "the system of natural liberty" that the sovereign should erect and maintain "certain public works which it can never be for the interest of any individual, or small number of individuals, to erect and maintain"; and though Smith's rule was formulated in the ante-railway age, still his language might by implication be construed as implying his approval of a state railroad system, for he remarks that the "expense of maintaining good roads and communication is, no doubt, beneficial to the whole society, and may therefore, without any injustice, be defrayed by the general contribution of the whole society."[1] In the United States prior to 1830 the construction and maintenance of highways was very generally a task assumed by the state and local governments. Some private toll pikes there were, but they were regarded as exceptional and as a temporary expedient. Not only the commonwealths and their local subdivisions, but even the federal government had made expenditures upon the construction of public highways. This policy of internal improvements came first to an end so far as the federal government was concerned when Jackson vetoed the Maysville-Road Bill.[2] Thereafter the task which had been laid aside by the federal government was taken up and pushed with zest by the

[1] Wealth of Nations, Bk. V., Chap. I. (p. 403 of Vol. II. of *Thorold Rogers'* edition).

[2] See H. C. Adams' Introduction to State Railroad Control by F. H. Dixon.

various commonwealths. The first period of railroad history in this country covers the two decades between 1830 and 1850, when railway building was in its infancy, and when most lines lay each entirely within a single state. The construction and operation of both railways and canals were in the hands of public officials. The result of this attempt was failure, complete, indubitable, and humiliating. Vast debts had been contracted for the construction of these works, and the states had to face the humiliating alternative of bearing crushing taxes or repudiating their debts.[1] The memory of this experiment has long ago vanished from the public mind, but the lesson which the experiment taught has been indelibly embedded in the constitutions of most of our states. These fundamental charters were overhauled and very generally amended by hard and fast limitations put upon the employment of the states' credit. Thus a practically complete severance of the state governments from all participation in industrial ventures was effected. The period which followed, from 1850 to 1870, saw the private corporation arise and undertake the work of railway construction and extension.[2] The belief in private and corporate initiative as the surest guarantee of needed railroad facilities was largely the result of a hard bought experience, and not the outcome of mere unthinking inclination or haphazard experiment. The railroad corporations tried successfully during this period to obtain public money and extensive grants of land from towns, counties, or municipalities. The Pacific roads received direct aid from Congress; but,

[1] For an account of this movement, see H. C. Adams, Public Debts, p. 317 *sq.*

[2] These periods apply mainly to the northern, central, and western states. The southern states, notably Missouri, aided railroads as late as 1868.

with all these exceptions, the public policy was to keep the hands of the state off, and to encourage the development of the railway system by giving private corporations the fullest opportunities to construct roads. Many of the railroad charters contained stipulations prescribing the maximum charges that might be imposed, but the public relied mainly upon the number of competing carriers by rail to escape the extortionate demands of a transportation monopoly. "Set the railroads at each other's throats," argued the public, "and we shall get fair play."

From this complaisant attitude the shock of awakening was most rude and unpleasant. But in 1870, after an enormous mileage had been laid down, and companies had multiplied by the score, complaints about railroad rates, especially in the middle West, became too violent to be longer disregarded. Since that time we have been conscious of the existence of a railroad problem, for which the mere unshackled competition of rival carriers is no solution, and we have made various efforts, mostly legislative, to solve it. The Granger agitation, as the movement in the West was called, was not only a protest "against the high aggregate charge imposed by the companies, but against the monstrous inequalities of charge."[1] Not only were special rates accorded where there existed natural causes, such as water competition or the competition of other railroads (which might justify or palliate the discrimination), but special rates were made to certain places and to certain people without the least warrant in reason or justice, and often to the extreme detriment or ruin of other shippers. Public opinion, too, was alarmed at the beginning of the process of "pooling," while the lavish grant of passenger

[1] A. B. Sticknev, The Railway Problem, p. 24.

passes but added fuel to the flame. The uprising against railroads occurred in various states about the same time, and there were two important results of these earlier struggles. One was the affirmation by the Supreme Court that railroads are by their nature affected with a public interest; that the legislature is the guardian of that interest, and may (subject to constitutional restrictions) control by commissions or otherwise the fixing of rates and the operation of the roads. The other result of prime importance was the creation of railroad commissions in many of the states. Some of these commissions had little power except that of investigating and making public their conclusions. This apparently was only "the power to scold," but where the commission, like that of Massachusetts, was able and impartial, and where more conservative traditions ruled amongst railroad men, the advisory commission through its influence on public opinion often proved to be powerful for good. In other states,[1] as in Illinois, the state railroad commission was intrusted with mandatory powers, and was given authority to alter or fix rates. The states very generally had passed statutes declaring that all rates must be reasonable, and that facilities should be afforded where possible for continuous carriage by the interchange of traffic. Discrimination in every form had been stringently forbidden, and in a number of the states the law prohibited a carrier from charging more for a short haul than for a long haul over the same line in the same direction, the circumstances and conditions of the haul being substantially similar. This proviso was intended to prevent discrimination against local traffic.

[1] See Dixon, State Railroad Control, for an account of Iowa's experiments with railroad commissions; also J. W. Million, State Aid to Railways in Missouri.

While it is difficult to generalize about the work of state railroad commissions, and while it must be admitted that much stringent legislation by crippling the companies hurt the shippers no less than the carriers, it seems probable that the state commissions effected a diminution in railroad discrimination. Complaints on that score, while they have never ceased, became less numerous, though this was doubtless due in part to the fact that a certain redistribution of population was effected by migration to the localities favored in the matter of rates.[1] The difficulty which all state commissions were alike powerless to meet was the existence of discrimination in the case of traffic which passed from one state into another. The regulation of such interstate traffic was jealously reserved by the decisions of the federal courts to Congress, and the state commissions found themselves simply impotent to prevent discrimination upon the greater part of the tonnage moved by rail. Very naturally there arose a cry for the federal regulation of railroads, and in March 1885 a select committee of the United States Senate was appointed to investigate the question of interstate commerce. That committee, with Senator Cullom at its head, began and successfully prosecuted a searching inquiry into the subject. Their report conclusively showed that practically all of the complaints against the railroads were traceable to the practice of discrimination. Upon the basis of this report the Interstate Commerce Act was drafted, was passed by Congress, and went into effect in April 1887.

This act, which is still the basis of our federal regula-

[1] "Statistics show that between 1870 and 1890 the increases in population in Illinois, Wisconsin, Iowa, and Minnesota were in cities which had competitive rates; and that non-competitive places decreased in population."—A. B. Stickney, The Railroad Problem, p. 62.

tion of railroads, is in part only declaratory of the common law of carriers. It requires all rates to be reasonable, and prohibits all kinds of pooling of traffic or of the earnings therefrom. To this extent the statute simply reenacts the common law.[1] Beyond this the act proceeds to forbid all kinds of discrimination in rates, and prohibits the exaction of any greater compensation for transportation for a shorter than for a longer distance over the same line in the same direction under substantially similar circumstances and conditions. This is commonly known as "the long and short haul clause," whose operation may be suspended at the discretion of the Interstate Commerce Commission. This body was created by the act, and consists of five members appointed by the President. They are clothed with power to enforce the provisions already mentioned. They are also required to see that rates and fares of interstate carriers are printed and made public, and have authority to inquire into the management of the business of such carriers either at their own instance or on petition of a plaintiff alleging that he is injured by the violation of the law. The statute also prescribes penalties for disobedience, and outlines various methods of procedure necessary for the enforcement of the provisions of the act.

The federal Interstate Commerce Commission has now been in existence for more than ten years, and there seems to be little likelihood of its speedy abolition. Like most experiments of a similar sort it has neither justified the fears of its early antagonists nor met the expectations of its most sanguine promoters. The commission's own

[1] Pooling has been regarded as a contract in restraint of trade and hence against public policy. The only change made by this law was to affix specific penalties to pooling.

utterances indicate that the existing law does not give them sufficient power to do the good they might, while the acquiescence of railroad men in the present state of things would indicate that they do not find their operations very seriously hampered by the commission. It would be impossible without going into the subject at great length to weigh carefully the effect of the commission's work in the last decade. It must suffice to say, in passing, that both the commission and the railroad companies recognize that the Interstate Commerce Act fails to touch the real source of the railroad problem—the control over the fixing of rates. Where the commission has done good is in dragging to light the practice of discrimination, personal and local, and in mitigating the evil of unjust discrimination while conceding the necessity of discrimination which is founded in reason. The declaration of the statute that all rates must be reasonable has proved to be a mere *brutum fulmen*, for the fall in railroad charges has been due to causes over which positive law exercises no control. The enforced publicity of rates has been rendered ineffective by the filing of thousands of tariffs amendatory to previous rate sheets. Few have the temerity, the time, or the curiosity to examine the shapeless bundle of rate sheets which hangs limp and repulsive in the ordinary passenger station, and the persistent and apparently ineradicable granting of special rates or rebates to favored shippers makes the published freight rates of little significance to any except the printer. The long and short haul provision is frequently suspended with the sanction of the commission. It is perhaps more often violated without the commission's knowledge. The anti-pooling clause has come in for more severe criticism than any other single section of the law. It has been, however, to all

intents and purposes, evaded by the action of various traffic associations comprising companies which voluntarily maintain rates designed to equitably divide traffic between them.

The Argument for Federal Acquisition and Operation of Railroads.—The argument for a state railroad system in the United States is of necessity an argument for the federal ownership and operation of that system. The very number of states composing the Union, the innumerable ties of common interest between them, and the total absence of any constitutional power in the commonwealths to touch interstate commerce make the ownership and control of transportation agencies by half a hundred states and territories unthinkable. The argument for federal ownership is based upon an indictment of the present railroad system.[1] To this indictment there are three main counts which allege that the present organization of railway transportation is inseparably bound

[1] Mention ought here to be made of the proposal of federal ownership and operation made by President Blackstone of the Chicago and Alton Railroad in the annual report for 1890. The demand for state railroads is generally made in the interest (real or supposed) of the public. President Blackstone, however, suggests federal purchase and control in the interest of investors in railroads. "Under present conditions," he says, "the politicians dictate railroad management, and those who have been so unwise as to invest their money in railroads suffer the loss. Apparently the people see no wrong in this, etc." I cannot help suspecting that this advocacy of state railroads was either the outcome of peculiarly exasperating circumstances then rife, or that there is a bit of irony at the bottom of it all. No one's vision of the whole railway question is keener than that of the C. & A.'s president. He wrote a correspondent in 1891 as follows: "If I correctly understand the matter, the real objection to government ownership and management of railroads is based upon the belief in the minds of the people that they cannot trust politicians with the management of railroads under conditions which would require the people to suffer losses resulting from their mismanagement." See G. H. Lewis, National Consolidation of the Railways, p. 188.

up with (1) unjust discrimination, (2) competitive waste, and (3) unendurable extortion. These charges must be considered *seriatim*.

(1) *Discrimination* by railroad companies may take two forms, local and personal. Local discrimination is imposing upon the traffic of certain places rates which apparently are relatively unfair as compared with the rates imposed upon the traffic of other places. Personal discrimination consists in charging different shippers in the same locality different amounts for substantially similar services. Obviously either kind of discrimination may be effected through the agency of freight classifications. Goods which ought in all fairness to be put in the same class may be put arbitrarily into different classes and subjected to different charges; or a special rate may be conceded upon some article only when shipped from a particular town, though this concession may work injury to other places not similarly circumstanced. The most common form of making discriminations, however, is by giving discounts, special rates, and rebates to favored shippers. Passenger passes instance one of the most irritating kinds of personal discrimination, though they are not very important in the aggregate.

This part of the indictment drawn against the carriers contains a great amount of truth. It is admitted that a considerable amount of apparent discrimination against certain localities is justified. Either the competition of water routes or of foreign (e.g. Canadian or Mexican) railroads renders inevitable a lower rate on through traffic than other places not served by a number of carriers have any right to demand or expect. Even when the company charges less for hauling freight from New York to San Francisco, for instance, than for hauling the same

load over the same line from New York to Ogden (Utah)[1] the seeming disparity may be inevitable and right.[2] There can, however, be no question of the fact that in many cases the surcharge upon local traffic is capable of no palliation. It is extortion pure and simple. Nor can there be any doubt of the existence to-day of thousands of special rates, rebates, and discounts made to favored shippers in violation of the law. No one can begin an inquiry on that score without finding special rates at almost every other turn. On the other hand it seems probable that the evil of discrimination is less extensive and less irritating than it was twenty years ago. In 1879 the New York City local freight agent of the New York Central and Hudson River Railroad admitted that "there was no such thing as a tariff for the whole of the local freight carried over that line within the state of New York," and that "every rate was a special rate varying according to circumstances and conditions."[3] The growing conservatism of railroad companies themselves has had much to do with abating the evils of extravagant discrimination. Some companies have realized that charging moderate rates for non-competitive freight is in general a prudent device for building up local traffic. On the whole, we may say that while it would be utopian to expect to see discrimination altogether disappear, still it is evident that the evils from this source have somewhat abated. Twenty-five years ago there was a general outcry over discrimination, each shipper fearing that he was worse abused than his neighbor; to-day the public complaints on the score of discrimina-

[1] Alexander, Railway Practice, p. 16.

[2] This has been so decided by the Interstate Commerce Commission, *In re* Louisville and Nashville Railroad Company. See the Commission's Annual Report for 1890, p. 139.

[3] Simon Sterne in "The Citizen" for Sept. 1896.

tion are far less noisy and frequent. Each shipper deludes himself with the idea that he has secured the lowest rate. Should the practice of unjust discrimination again grow virulent, the remedy proposed by Mr. Stickney[1] might become law. This would allow the Interstate Commerce Commission, upon convicting a company of unjust discrimination, to operate the road through a receiver until ample security had been given against any repetition of the offence.

When all is said in mitigation of the practice of discrimination, it must be allowed that the evil is very grave, and perhaps impossible of extirpation so long as roads are operated by private corporations. The evil exists in England[2] as well as in the United States, and would seem to be the inevitable result of a competitive railroad system.

(2) *Competitive Waste.* The advocates of state railroads do not content themselves with unearthing the injustice now wrought through unjust discrimination. They allege that the corporate operation of railroads is a wasteful system, and that the wrong it perpetrates by granting special rates and secret rebates is aggravated rather than offset by the unnecessary waste of the nation's resources which railroad rivalry entails. In particular they assert that railroads are now frequently built where they are not needed, or before they are needed; that the motive which prompts to their construction is to blackmail existing companies into buying the new road on pain of losing traffic; that the value of a new road depends not on its power to serve the public, but on "its power to do mischief"; that the building of roads through the agency of construction companies

[1] Cf. The Railway Problem, p. 211.
[2] Cf. J. S. Jeans, Railway Problems, p. 293.

in the United States is replete with corruption and extravagance; that the cost of construction and operation is less on state railroads than on private roads, and that the rivalry of competing carriers necessitates the maintenance of many extensive staffs, and numerous other competitive agencies which might be cut down or abolished were the system entirely in the hands of the government.

It is undoubtedly true that many single instances may be cited which go to illustrate the foregoing contentions, but it is doubtful if such instances in the aggregate are sufficient to prove the general allegation of the greater wastefulness of the present system over the state system. The testimony on the cost of railroad construction by the state and by private companies respectively is drawn almost entirely from foreign experience and is far from being conclusive.[1] Very much the same must be said about the testimony bearing upon the cost of operation of state and private roads. There is something to be said for the contention that the joint operation of the railroads, the telegraphs, and the post (as in Prussia) affords an opportunity for economy through unity of administration and extended division of labor. On the other hand it is notorious that it is more difficult in slack times to discharge unnecessary agents from the state civil service than from a private concern. At all events the variations in the cost of operating railroads in different countries seem to indicate that there are factors of much greater importance in determining the

[1] Picard (Traité des Chemins de Fer, I., p. 539) pronounces the following guarded conclusion: "A tous ces points de vue, nous considérons la construction par l'État comme donnant des résultats, sinon supérieurs, au moins égaux à ceux de la construction par les concessionnaires."

cost of operation than the character of the directing agency.[1]

Unquestionably there is in all competition a certain amount of expenditure purely wasteful when considered by itself. The maintenance of huge advertising bureaus, the multiplication of ticket agencies, the vast commissions paid to freight and passenger promoters, the diversion of traffic over circuitous lines, especially during railway "wars," the rapid change in rates (happily less frequent than formerly), and the disastrous gambling in railroad securities must all be recognized as among the social costs of competitive railroading. Still it remains an open question after all whether these wasteful expenditures are not the inevitable concomitants of competition, which, be its drawbacks what they may, is the most reliable guarantee yet evolved of cheap and efficient transportation.

(3) *Extortion.* The charge preferred against the present railroad system on the score of widespread and systematic extortion may be dismissed with but few words. It is of course conceded that numberless instances are on record where railroad companies have used their

[1] Leroy-Beaulieu (Traité des Finances, I., p. 104 *sq.*) argues for the superior economy of corporate management. He points out that the ratio of net receipts to gross receipts per mile operated, (coefficient d'exploitation) is less on private roads than on state roads in Europe generally. This would indicate that, *ceteris paribus*, it takes a greater fraction of gross earnings to pay expenses on state lines than on private lines. Jeans (Railway Problems, p. 461 *sq.*) cites tables to prove that on private lines a greater percentage of the total working expenses is laid out on the administrative staff and traffic expenses than is the case on state lines. The maintenance of way on the other hand, he admits, absorbs a greater part of the total expenditure on state roads than on private roads, though he ascribes this to the superior care taken of state roads. Picard (Traité des Chemins de Fer, I., p. 624) asserts that the coefficient d'exploitation, when all circumstances are considered, is about the same in France, Belgium, and Germany.

monopoly power to exact the last cent that could be wrung from the helpless shipper. But a comparison of our railroad charges, both passenger and freight, with those levied on Continental lines will effectually dispel the idea that the average charge for transportation in the United States is exorbitant. It is easy to attach too much importance to these statistical averages; but it was estimated that in 1892 while the average rate per passenger-mile in Europe (including Great Britain) was 1.93 cents, the corresponding charge in the United States was 2.143 cents. On the other hand, while the average European freight charge per ton-mile was 2.02 cents, the average rate in this country was 0.967 cents.[1] Equally significant is the steadily decreasing rate of freight earnings per ton-mile in the United States, the decline being from 0.839 cents in 1895 to 0.821 cents in 1896.[2] In view of these considerations and of the very moderate average rate of earnings on the real capital invested in our railroads, the cry about exorbitant dividends resulting from general extortion falls flat.[3]

The advocates of state roads do not generally content themselves with descanting upon the evils ingrained in a competitive system, but usually cite the success of state railroads (Prussia and Austria are favorite illustrations), as a clinching argument in favor of inaugurating a similar system in the United States. Without attempting here to rebut this assertion of the success

[1] These comparisons are taken from Facts and Figures by J. H. Benton. The Statistician to the Commission (Report for 1895, p. 75) makes the average revenue from freight per ton-mile in the United States, in 1892, but 0.898 cents.

[2] Poor's Manual of Railroads for 1897.

[3] "The deficit for the year ending June 30, 1894, was $45,851,294, showing that the railroads have run behind during the two years in question $75,696,535. Should this continue, either the investments or the credits of railways must disappear." Statistics of Railways in the United States for 1895, p. 58.

of state systems elsewhere, or to break the force of the argument by alluding to conspicuous failures of state systems (in Italy or Victoria for example), it may not be amiss to point out that a state system superimposed on what was originally a competitive system hardly gives a fair index of what state railroads, pure and simple, are likely to be and do. He is a rash judge, moreover, who, even though he be convinced of the success of an industrial experiment in one nation, argues that differences in national character, political habits, and business usages are likely to prove disturbing factors of but minor importance when the same venture is tried again under other skies.

The Argument against State Railroads.[1]—At the risk

[1] Certain compromise systems seeking to secure the advantages of both state and private railways without the defects of either have from time to time been proposed. Lack of space prevents more than the merest mention of some of them. Competent opinion, however, seems adverse to their practicability. The scheme of having a part of the railway system owned and operated by the government has been tried in Belgium and in Prussia. It was supposed that the private companies would be held in check by the necessity of meeting the competition of state lines. The actual outcome was very different. In Belgium the private roads set the pace, and the state roads were compelled to follow. (See Hadley, Railroad Transportation, p. 214 *sq.*) The government was finally compelled to buy up the greater part of the independent lines, and to enter into pooling arrangements with the remainder. In Prussia it would appear that the competition offered by the state roads had in some instances very seriously lessened the earning power of private lines, even to the extent of a partial confiscation of certain properties. These lines were afterwards purchased by the state. (See von der Leyen in Conrad's Handwörterbuch. Bd. I., pp. 176, 177). Permanent regulation of private companies by the concurrent competition of independent state lines seems to be impossible.

Some have advocated a plan which would combine state ownership of railways with their operation by private companies leasing the roads from the state. The Italian system is, in a way, built on this foundation. It is found, however, that such a lease must be conceded for a long term of years. The requisite amount of capital will not be invested unless some guarantee

of burning our bridges behind us at the outset, we may preface the case against state railroads by conceding that much of the milder and tentative legislation against railroad abuses has proved abortive. Especially true is this of laws setting maximum rates for railway service, and of laws limiting the dividends of railway companies. Self-interest in the first case has generally been sufficient to induce the companies to ask rates below the maxima legally set. In the second case, where railway earnings have been large enough to pay dividends whose rate exceeded that fixed by law, some device such as the issue of watered stock has commonly served to transfer the extra earnings to the stockholder's pockets without any infraction of the letter of the statute. The limitation of dividends in certain cases may even operate against the public interest, for if railway earnings and dividends can be increased by a reduction in railway rates, both the public and the railroad owners will gain thereby, whereas a limitation of dividends, if enforced, may serve not only to keep railway incomes down, but also to keep railway rates up.

If, then, laws limiting rates and dividends are universally ineffectual, and laws against unjust discrimination are frequently evaded or defied, we must admit that a

is made of the investment's duration. In Italy, for example, the leases run for sixty years, and to vacate them twenty years' notice is necessary. The idea, therefore, that the state, by being the legal owner of the railways, can exercise any effective control over a tenant, who cannot be ousted until after a generation, is evidently illusory. (See von Scheel in Schoenberg's Handbuch, Bd. III., p. 93). The plan of having the government, instead of purchasing the railways outright, lease the roads and operate them, differs only technically from complete ownership and management. Instead of paying interest on the purchase money borrowed to buy the property, the state would pay an annual rental for its use. Indeed this may be considered as a species of state railroads rather than a compromise system.

certain persistence of unjust discrimination as well as of competitive waste seems under present circumstances to be inevitable. The economic surd resists all attempts at elimination. But whether, in despair of a complete solution on present lines, we are ready to assume that state management is the inevitable remedy remains for consideration. Wagner urges with great force against a private system of railways that their management is necessarily dictated by the peremptory demands of private profit.[1] A "beneficent despot," if intrusted with the management of a national railway system, would not be exclusively actuated by the motive of increasing the net earnings of the railroad companies. Rates that merely cover cost or which perhaps result in actual loss that taxation must make good, may conceivably imply an increase in general well-being so great as to dwarf the temporary loss of dividends to the investors. Where the state owns and operates the roads, it is not, in determining railway charges, shut up in a narrow place like the private corporation, but with freer hand and more far-sighted vision may prescribe rates designed to secure the greatest public good. This possibility, however, would be realized, it must be remembered, only to the degree in which the government approximated an all-wise and "beneficent despot." Make concrete our idea of government by calling to mind that it consists to all intents and purposes of two rather numerous bodies of men of like passions as the rest of us, with conflicting views upon most subjects, and united mainly in "going in for the old flag and an appropriation," each for his own section, and we may easily understand how far our gov-

[1] "Der Vortheil beim Staatsbahnwesen besteht jedoch eben darin, dass eine solche Verwaltung nach dem rein gewerblichen Grundsatz nicht unbedingt nötig ist." Finanzwissenschaft, Bd. I., p. 659.

ernment falls short of the stature of the "beneficent despot" required. It is absurd to think we ever shall have a government that does all things well. The most we have any right to expect is one which does but few things mischievously. For this very reason we may with a good conscience renounce the hypothetical possibility of good inherent in state railway management, and fling ourselves boldly into the arms of competition. It is true that each and every system will accordingly be run with an eye single to corporate profits. But if cheap and efficient transportation results therefrom, we shall have solid compensation for the nebulous possibilities of good we have foregone. Does a competitive railway régime result in cheap and efficient transportation? Of the effectiveness of private initiative to lay out and construct the original network there is little question. The advocates of state systems seem to forget that there is one thing worse than having railroads operated ill, and that is not having them operated at all; and no more indisputable claim can be made for private initiative than that, where allowed free play, it has speedily and intelligently furnished the necessary transportation facilities. Governments have practically conceded their inferiority to private companies in the matter of projecting and building the original lines; and where the lack of private enterprise has compelled governments to take up the work of construction, it has been chiefly in those nations where the spirit of industrial self-reliance and venturesomeness has been traditionally repressed. Lord Farrer, a competent judge of the matter, testifies that the "development of railway communication in Great Britain has been such as no government management, however good, could possibly have produced."[1] "In railroad-

[1] The State in Relation to Trade, p. 109.

ing," says Mr. Croker, the chairman of the Massachusetts Board of Railroad Commissioners, "competition has wrought the work of improvement more wonderfully than in any other industry."[2] Evidence has already been cited to show how, in the United States, rates have been steadily reduced until they are as a whole unrivalled for cheapness. Whatever be the ultimate character of our railway system, the judgment of the future can hardly fail to acknowledge the wisdom of the past in that with singular clear-sightedness our century has realized its own great need, to wit, cheap, extensive, and efficient transportation, which it has secured by a courageous and thoroughgoing reliance upon private agencies acting under a fierce competitive pressure. It is true that we trusted to competition to secure what it could not secure, namely, rates based on cost of service. It is true that we relied on competition to prevent injustice, or relative extortion, as between shipper and shipper. In both cases our hopes were grounded on the sand. But the net result has convincingly vindicated our policy in the past. Rates are cheaper than any system of basing them on cost of service would have secured; and if the persistence of unjust discrimination, and of occasional railroad dishonesty, and the thousand and one abuses of power may give us real apprehension for the future, we may on the other hand, from the survey of what has already been accomplished, find abundant ground for hope.

Pooling.—A careful analysis of what we may reasonably expect from competition in the future brings us very near the heart of the real "railroad problem" of to-day. The possibilities of public good involved in competition are so vast that any proposal to curtail its

[1] The Railroads and the Public, p. 7.

free play is justly the subject of *prima facie* suspicion. Still we have seen that competition has been incapable of securing universally that reasonable equity in railway rates which positive law contemplates. Mr. A. B. Stickney and others go so far as to say of competition in railroading that "where it prevents extortion it produces discrimination." Evidently the results of such competition are not all of a kind. It remains therefore to inquire what its detrimental effects are and whether any bounds should be set to its operation. To be healthful, industrial competition in transportation must evidently secure not only efficient service to the public at reasonable rates, but to the investor such a return as will guarantee the extension of transportation facilities when and where such extensions are needed. Nor ought such healthful competition to involve a destructive pressure upon competent rivals or any part of the public. Such healthful competition in railroading cannot be secured without the violation or circumvention of the anti-pooling clause of the present Interstate Commerce Act. The reasons are these. Railroad systems in this country constitute an interlaced network of lines. A change in the rate sheets of any one line inevitably operates upon the traffic receipts of other lines. The boundaries of the various territories drained by these arteries of commerce are thus arbitrarily dislocated by changes in a single rate sheet. The volume of competitive traffic is reshifted, the stream seeking an enlarged outlet over the line which has cut its rates, until a retaliatory cut has been made by other companies. Thus the equilibrium of the whole transportation system may be disturbed by any one of four or five hundred independent rate making bodies. Of course this is true of small producers of manufactured goods where a cut in prices must

be met by competing producers. But the capital invested in such enterprises is relatively small, and continued sales below cost mean speedy dissipation of the capital and equally speedy elimination of reckless or incompetent producers. Hence cost forms a level below which such prices cannot remain for any length of time. The immense capital invested in railroads, and the practical impossibility of ceasing to operate them, when bankrupt, prolong the evil of excessive railroad competition, and prevent the total disappearance of the competing road. It may be absorbed, if bankrupt, by its successful rival, which becomes thereby absolved in a measure from the necessity of setting reasonable rates; or, if the bankrupt road is reorganized by an independent corporation, the battle-ground is but prepared again for a struggle like the first, unless through some joint arrangement the companies agree upon a *modus vivendi.*

The necessity of meeting cut-throat competition for competitive traffic impels roads having a virtual monopoly over the traffic of certain districts to extort from this traffic the highest practicable return. Thus they shift a certain part of the competitive pressure upon unfortunate shippers or localities. It is undoubtedly true that many shippers and the general public enjoy low rates during a railroad war. But the fluctuations produced first by the carriers' cuts, and then by the arbitrary increase of rates resulting from the patching up of a temporary truce, are fatal to all commercial calculations based upon steady freight charges. Besides the element of uncertainty thus introduced into all business where freight charges are a considerable item, the disappearance of railway profits in the immediate present acts as a brake upon the extension of railway facilities in the future. Hence the idea that railway wars are public benefits is

lamentably short-sighted. The truth is that competition among railway carriers has been so extreme that the public interest no longer consists in spurring them on to internecine strife, but rather in legalizing their pooling arrangements,[1] without which the companies must continue a policy ruinous to themselves and dangerous as well to the public. It was owing to the fear of monopoly that the anti-pooling clause was incorporated in the Interstate Commerce Act. But this provision tended to perpetuate and even to augment that discrimination which it was the main object of the law to destroy. The competition which the anti-pooling clause sought to foment gave the carriers a new motive to discriminate where possible, in order thereby to lessen their losses on competitive traffic.[2] The law enjoined upon the carrier the duty of undeviating competition, and then turned around and sought to deprive him of the only means of recouping the losses which such unflagging competition inflicted upon him. The only avenues of escape from bankruptcy were consolidation of competing roads, or evasion of the anti-pooling clause. The possible danger inherent in pooling is the imposition of extortionate charges by the companies. But this danger is rather imaginary than real. Rates fixed by pooling agreements must conform to the requirement of being "reasonable and just," and, unless the law were

[1] Pooling arrangements take different forms. The most common form is a voluntary acquiescence on the part of carriers in differential rates recommended by a Joint Traffic Association Board, or similar body composed of representatives of the various roads. These rates are based upon the length of route and the character of service of the respective roads. The earlier pools sought to divide joint earnings, or to distribute competitive territory, or to fix each road's share of the total volume of traffic.

[2] Cf. H. T. Newcomb's article in the Popular Science Monthly for Oct. 1897.

otherwise changed, would continue to be subject to review by the federal commission. There is also evidence to show that "as a rule the rates on pooled traffic have been reasonable and equitably adjusted, and have been brought into comparatively harmonious relations with local rates."[1] Nor must it be imagined that the legitimation of such pooling contracts would destroy competition. The competition of carriers by water would still continue. Even with the stiffest maintenance of differential rates, the competitive struggle would largely persist in the form of offering to shippers and passengers superior railway facilities. Whatever be the ultimate outcome of the railroad problem, one thing is certain, that the possibility of deranging all rates at the mere caprice of any one of several hundred rate fixing bodies cannot continue. Exactly how this chaos-breeding power will be chained it is difficult to say. It may be that hard won experience will make carriers voluntarily conform to rates recommended as at present by traffic associations. It may be that specific rates based on the principle of making aggregate earnings cover aggregate expenses will be prescribed and enforced by the federal commission.[2] It is possible that the actual consolidation of all systems under a single board of control will destroy conflicting interests by unifying them. Sev-

[1] W. D. Dabney, The Public Regulation of Railways, p. 152.

[2] Mr. A. B. Stickney in Ch. XIX of the Railway Problem, argues that there is no other remedy. Prof. H. C. Adams has advocated a similar plan. He suggests that the Commission might (1) determine the proper total income of railway companies; (2) the share of traffic naturally belonging to each company; (3) a uniform classification of freight; and determine (4) on each class, rates that should be sufficient when multiplied by the physical volume of traffic to produce the aggregate income. (See Compendium of Transportation Theories edited by C. C. McCain, p. 134 *sq.*) To suggest only one of a thousand difficulties, how would such rates be affected by large unforeseen fluctuations in the volume of traffic?

eral ineffectual attempts at a solution have already been made. The federal commission has been foiled in its attempt to prescribe in advance specific rates to be observed by carriers; and the efforts made hitherto by carriers to establish mutual agreements to maintain reasonable rates have been annulled by the decisions of the Supreme Court. The Interstate Commerce Act, so the Supreme Court has decided, confers upon the commission no power to prescribe rates for the future;[1] and the Anti-Trust Law of July 2, 1890 (in the opinion of the same tribunal) prevents a railroad company from entering into any combination with competing roads even to maintain reasonable rates.[2] These decisions apparently block progress along their respective lines so long as the statutes concerned stand unrepealed or unamended, but in some way the control over the fixing of rates must be secured.

The advocacy of pooling, then, is far from being an admission of the failure of competitive railroading. The necessity for pooling is rather an index of the thoroughness with which competition has done its work in the past. Moreover, the compatibility of such pooling arrangements with cheap and efficient transportation is a strong argument against governmental experimentation with railroads.

The Political Aspect of the Question.—If, by proving the indispensable advantages of reasonable competition, a tolerably strong argument for retaining our present system of private railroads may be made, a conclusive demonstration of the folly of a federal railroad system

[1] *In re* Interstate Commerce Commission *vs.* The Cincinnati, New Orleans and Texas Pacific Railway Co. *et al.*

[2] *In re* U. S. *vs.* The Trans-Missouri Freight Association *et al.* For a clear presentation of both decisions see Prof. E. R. Johnson's article, Current Transportation Topics, in Annals of the American Academy, Sept. 1897.

may be drawn from weighing the political dangers which such a system must certainly entail.

The dangers of a national railroad system are many. It would miraculously multiply the "loaves and fishes" for the politicians to dispense; it would make transportation facilities the football of political "dickers"; it would plunge the Treasury into straits whenever there came a slump in railroad earnings; and, worse than all else, it would raze to the ground our constitutional structure based on a balance of power between the government and the people.

Let us endeavor to substantiate these propositions. The Statistician to the Interstate Commerce Commission reported that on June 30, 1897, there were in all 823,476 men in the employ of the railroads of the United States.[1] Substantially 800,000 citizens, representing a population of about 4,000,000 souls, would become employés in the federal civil service under a state railway régime. This number added to the present civil service roll would make the total number of places under the federal government largely in excess of 1,000,000. The advocates of state roads when confronted with this situation try to meet it by saying that all these 800,000 places must, of course, be filled under a system of competitive examinations. Obviously there would be thousands of places that could not be thus filled. The more important positions, the superintendencies of divisions and the like, would be conceded to be the proper political patronage of every administration. Promotions and transfers would afford another mass of plunder to the politicians.

The maintenance of the reforms already effected in the public civil service is no easy labor; and the exten-

[1] Statistics of Railways in the United States, 1897, p. 37. The number employed in 1896 was 826,620.

sion of the competitive system of appointments and promotions to a field indefinitely vaster than the present one might not improbably prove a superhuman task. To argue that the inefficiency of partisan railroad service would make patent the necessity of the merit system, and would thus lead to an overwhelming popular demand for the universal establishment of the merit system in the administration of state railroads, does not appear to be a very cogent argument. Popular opinion in America will always demand and obtain a very considerable degree of administrative efficiency even from a partisan civil service. Indeed it may fairly be doubted whether the superior efficiency and economy resulting from a non-partisan civil service are more important than the elevation of politics which results from the merit system. Place and power are and always will be the incentives to political activity. The political experience of our race has demonstrated the necessity of limiting by constitutional prohibitions the power of our rulers. We are beginning to learn the wisdom of limiting the places to be scrambled for in the political *mêlée*. It is therefore doubtful whether a partisan railway administration would be so inefficient as to engender an indefeasible clamor for extending the merit system to the public railway service. Even if such a movement arose, the "vested interests" of the vast army of incumbents might easily block the attempted reform. However, even though we concede that the government railway service would be ultimately brought under the merit system, the dangers that might arise from the united action of a compact body of a million government employés are not illusory. The fact that a man got his position by merit is no guarantee that he will not try to raise his salary by political agitation. The bidding

for the "labor vote" (with which we are already familiar) would be child's play to the havoc wrought by bidding for the railroad vote. When Congress sets the wages for a million men, somebody's fingers are going to get burned; and whose they will be we may judge from our pension experience. There are indeed those who are hardy enough to suggest that the railway employés of the government "forego suffrage," or, as President Blackstone in semi-ecclesiastical phrase puts it, that "railroad operators . . . be in no greater degree under the influence of politicians or political parties than the army militant." The "army militant," it may be remarked in passing, has numbered in times of peace about 25,000 men. To suggest wholesale disfranchisement of a million citizens is puerile: and to hope for their political indifference when rival parties are riotously bidding for their votes is to hug a delusion. The dilemma is plain. A state railway system must adopt the merit system or reject it. If the merit system be rejected, we invite the politicians to go through our pockets; if the merit system be adopted, the very number of state railroad employés and their conscious power will tempt *them* to go through our pockets. In the second place a régime of state railroads in this country would imply the submission of rate fixing to political influences. The pressure now exerted on congressmen to secure legislation for special sections is admitted. Not an appropriation bill for rivers and harbors passes Congress but it is loaded with special favors of this kind. Not a tariff measure, whether protective or otherwise, has passed Congress in this generation but special interests, industrial and sectional, have employed it as an engine for legislative favoritism. Let the fixation of transportation rates and facilities be flung into the political arena, and

the "woes unnumbered" of the unrepresented nation at large may be faintly conjectured. It does very well to say that a federal railway system will make the government the guardian of every interest, the patron saint of investor, shipper, employé, and every competing interest, but it is tolerably safe to predict that the very struggle of locality with locality and of interest with interest for preference in the matter of rates will soon reveal in this general benefactor a universal scourge.[1]

The Financial Aspect of the Question.—Lastly, the purely financial tasks of the Treasury would become freighted with insurmountable dangers. The total ordinary federal expenditure at present is in the neighborhood of $350,000,000 a year. The capital invested in railroad property in the United States is estimated at $11,000,000,000. In case the federal government in order to purchase this property issued bonds to this amount, the interest upon so stupendous a debt would more than double the total annual expenditures. To offset this increased expenditure the government would receive the earnings of the railroads. In times of commercial depression these earnings, sometimes for several years running, are a negative quality. Even assuming that the government administration is as economical as that of the railroad corporations, the necessity of paying off each year some part of the principal of the debt incurred for the purchase of the roads would about absorb the surplus of net earnings over interest charges. It may readily be surmised that the Secretary of the Treasury in a lean year would have a

[1] Picard (Traité des Chemins de Fer, I., p. 625) remarks sagely: "Quoi qu'il en soit, sur ce point comme sur celui que nous discutions précédemment, il est difficile d'envisager sans quelque apprehension l'influence que pourraient avoir en France les pressions politiques sur le nombre des trains, la consistence du personnel et les autres éléments du prix de revient de l'exploitation."

riddle to read, an easy answer to which would be Repudiation.

All of the dangers, however, which inhere in a federal railroad system but constitute the greater danger already adverted to, of building up a bureaucracy disproportionate to our political system, and of intrusting to the government a power so great as to dwarf the individual units balanced against it. Professor H. C. Adams has put this admirably where he says[1]: "The question involved is a constitutional and not an industrial question. The discussion pertinent to the problem takes into consideration the influence which government ownership of a railway will have upon the fundamental structure of the state. The Constitution of the United States is unique in that it aims to guarantee the continuance of liberty through a balance between the various governmental powers; and . . . the great body of the American people hold to the political ideas expressed in the Constitution. More than this is true. Not only is the theory of the balance of governmental powers relied upon for the perpetuation of political liberty, but the conception of a balance as between governmental functions on the one hand and industrial functions on the other is accepted as a criterion of a justly organized society. . . . The administration of railroads by government would increase the importance of the administrative department of government as compared with the other departments, and it would also throw so preponderating an influence into the hands of government as to destroy the hope of maintaining any just balance between governmental and individual interests."

The last resort of the advocate of state railroads is to argue from the successful management of the post-office,

[1] Introduction to Dixon's State Railroad Control, pp. 13, 14.

or the brilliant administration of Prussian railroads, that our federal government is able to undertake the business of transportation. The many differences between the post and the railroads have already been explained, and the analogical argument that Prussian success with railroads presages similar good fortune for our federal government in a similar venture is far from conclusive. If we are to make use of analogy as a guide in such matters, the experiment which deserves our most careful study is the English experiment with the telegraphs. Here was a nation whose industrial habits were most nearly like our own. Here was an industry whose acquisition cost far less than the railroads, and whose administration was immensely simpler. Moreover, conservative financial opinion had pronounced in favor of the experiment. So careful a student as Jevons had concluded that state telegraphs would be successful largely for the same reasons which had made the state management of the post successful.[1] It was found, however, that the economies secured by unity of management were offset by the higher salaries paid to employés, and that the government had to obtain a monopoly for the state telegraph, though formerly such an intention had been disclaimed. The financial failure of the experiment is hardly in question. A successful pressure of the telegraph personnel for higher pay, and an invincible demand by the public for lower rates, proved to be the upper and nether millstones between which the financial success of the undertaking was ground to powder.[2]

[1] Compare Jevons, Methods of Social Reform, p. 281.
[2] Bastable, Public Finance, pp. 197, 198.

CHAPTER XI.

MUNICIPAL MONOPOLIES.

Nature of Urban Monopolies. — "All the conditions that made a uniform system of local self-government possible," Mr. Wilcox[1] tells us, were "swept away by the rise of cities." He might have added that the conditions which made a uniform system of industrial competition feasible were also largely shattered by this same exodus from the country to the town. For as the growing concentration of population into cities at once created a closer dependence of social welfare upon intelligent city government, so the very fact of urban residence created a *milieu* in which the beneficent force of free and equal competition could no longer freely 'orb about.' The machinery of the town meeting could not cope with the inert masses to be moved within great manufacturing and commercial centres, nor could the unrestricted industrial rivalry of an agricultural era afford an adequate rule of economic policy for the growing municipality. With the growth of cities came, of necessity, the concurrent growth of the city plant. The old village lanes were transformed into thoroughfares paved, graded, and curbed. Public buildings were multiplied. Public bridges, and markets, and docks, and wharves, and ferries supplanted earlier and ruder contrivances. The uncouth rural constable gave way to the uniformed

[1] Study of City Government, p. 9.

patrolman, and in place of the voluntary hose company came the salaried fire department.

It is hardly surprising that in a period of such rapid material progress there should have been few misgivings about the danger of extortionate charges for services which city residents were sure to require. The levelling effect of industrial competition upon prices had exerted a sedative or at least a reassuring influence upon city people; and they were slow to grasp the fact that in certain important urban industries the action of competition is impeded or wholly checked. They understood from the first that the city was a governmental organ of the state, but they assented only gingerly to the broad doctrine that the city was also the normal minister to peculiar local needs. They assumed that their officials would employ a part of the city plant, such as the public administrative buildings and the schools, and would render gratuitous services in connection therewith. But the citizens generally saw nothing inconsistent with this policy in granting (often in perpetuity, and without any remuneration) the use of another and greater part of the city plant, to wit, the streets, to companies or corporations whose object was to make money by supplying the city with water, gas, electricity, or the means of local transit.

If the times of this ignorance cannot now be 'winked at' they may at least be partly condoned. When franchises were originally accorded, entitling the grantee to the use of the streets, the necessity for the services to be rendered was often urgent, the success of the project was often doubtful, and the monopoly character of the privilege was often but dimly perceived. Many city governments pursued the somewhat illogical, if on the whole advantageous, policy of supplying the city with water,

while turning over to private companies the business of supplying the citizens with light and transportation. The necessity of an adequate water-supply was too imperative and too obvious to wholly escape public attention and interest even at the first, and it was naïvely imagined that extortionate charges for other services, if imposed by a private company, would speedily call into existence plenty of rivals to whom it would be but necessary to grant a similar use of the streets in order to bring down prices to a competitive level. This proved to be a mistake. It was found in the first place physically impossible to lay more than a certain number of car tracks upon the surface of the street, or more than a certain number of pipes and wires below that surface. In the second place, this perpetual tearing up of the public thoroughfares, with the consequent interruption of public traffic, was an intolerable nuisance. In the third place, the apportionment of the city between competing companies rendering public service gave the public far less efficient service than could be rendered through a single management. Competing street-car lines, for instance, would naturally not give transfers upon each other; whereas a single system could frequently be coerced into conceding such a privilege. Moreover, competition was a wasteful system, as the unnecessary duplication of tracks, mains, and apparatus showed; and to crown all, such competition tended naturally to disappear, as consolidation of competing interests promised such obvious advantages to the former competitors.

In short, the rapid increase of the city population led to the creation of an immense public plant. The services connected with the supply of water, gas, electricity, and local transportation involved the use of portions of this public plant. Such services tended to become mo-

nopolies, and the attempt to raise up rivals to these urban monopolies proved radically ineffective.

Choice of Policies — Under conditions such as have been described the choice was forced upon our municipalities of rendering directly to their citizens such services as required the use of the streets, or of exacting in the future from private companies some adequate compensation for their franchises. The water-supply had been very generally undertaken by our city governments [1] and a few cities, notably Philadelphia and Richmond, Va., had instituted municipal gas-works. But there were in general two great obstacles to the 'municipalization' of these public service industries. One was the widespread feeling against the government's entering upon industrial ventures; the other was the fact that the public service corporations already existing were frequently in possession of privileges and concessions which could not legally be revoked, nor bought back except at exorbitant prices. When electricity began to be used, American cities, either because they had begun to realize the true nature of urban monopolies, or, more probably, because they were moved by representations

[1] In 1835 only 27.8 per cent. of the waterworks in the United States were owned by the public. The percentage of publicly owned works steadily increased, being 45.3 in 1855 and 54 in 1875. This is practically the percentage of public waterworks at the present time (1897). It is noteworthy that there are but nine of our fifty largest cities now supplied by waterworks owned by private companies. What changes have been made have been in the line of replacing private waterworks with public plants. The public ownership of gas works is much more common in England and on the Continent than in the United States. In England and Wales the private gas works number 426 to 160 owned by the local authorities. It is not infrequent to find that the trackage of tramways in England is owned by cities, and let by them to operating companies which supply the cars and service. Several municipalities in Great Britain have followed the example of Glasgow in both owning and operating their street-car lines.

of the supposed saving to be effected, instituted in more than a hundred instances municipal electric light plants. Even where our cities have adhered to their earlier policy of letting private corporations render public services, the city governments have been more exacting than formerly in the various stipulations inserted in the franchises. Originally, such franchises were to be had almost for the asking. In certain cases they were perpetual instead of being limited in duration, and they often conferred what were practically exclusive rights to serve certain localities or districts. Franchises granted to-day are likely to be hedged about with many restrictions. The right is frequently reserved to the city government of prescribing the conditions and character of the service to be rendered; the franchise is limited in duration, and a special tax of a certain percentage of the gross receipts or of the net receipts is often inserted. Even the right to fix the prices to be charged is not infrequently reserved to the city, though the exercise of this last-named right is likely to be treated very cavalierly by the courts.

It is almost needless to add that the municipal ownership and operation of urban monopolies is what is vulgarly termed one of the 'burning questions' of the day. To assess the arguments for and against such a policy we must have regard first, to certain general considerations, economic and political, and thereafter we must weigh the positive evidence to be drawn from experience and statistical inquiry.

Direct Municipal Service vs. the Franchise Policy.— The advocates of direct municipal ownership and operation of urban monopolies hold out the alluring promise of transmuting private profits into public benefits. The supply of light and water, no less than local transportation, they contend, is ordinarily a monopoly. The prices

exacted for these services, they aver, are monopoly prices, sufficient to line the pockets of the private corporations with exorbitant profits. Even admitting that private watchfulness depresses cost below the cost level of municipal service, the consumer, they argue, is not benefited thereby. The pressure exerted on the corporation's employé does not lessen the consumer's water-rate, nor his gas bill, nor his car fare. Instead of helping either consumer or employé, the monopoly, it is maintained, robs the one and tyrannizes over the other. And even though it be admitted that public management is less economical than private control, still it is argued that the possible risk of public waste is slight as compared with the certain danger of corporate greed.

In criticism of this position it may be said, first, that this elimination of private profit is possible, generally speaking, only as regards enterprises to be established in the future, where the city government assumes the risk of failure as well as of success; secondly, that the element of cost is not the item of trifling importance it is represented to be, but that it measures the waste incurred in operating an industry, and is therefore of cardinal significance; and thirdly, that even if public management secured lower prices to the consumer in the immediate present, such a plan would be dearly purchased at the cost of slackened industrial improvement. To illustrate: if a street-railway company has a franchise which is unlimited in duration and which carries with it the exclusive right to operate on certain thoroughfares, such a franchise cannot be revoked, nor its value be indirectly destroyed by the city. Such action would be both unwise, as endangering private property, and unconstitutional, as it amounts to taking private property without

just compensation.[1] If through the exercise of the right of eminent domain the franchise become the property of the state, the price paid by the city would normally be based on the earning power which the franchise formerly conferred on the company. Even though the expiry of a corporation's charter should allow the city government to establish a municipal plant and render services directly to the citizens, the obvious utility of acquiring the existing private plant would generally lead the city to pay a price for it high enough to cover and more than cover the cost of the plant's duplication. When the city therefore is under the necessity of making the earnings of its enterprises cover the interest and redemption of this purchase money, there is no certainty that such charges will not prove fully as onerous as the corporate profits from which municipal public service was intended to deliver us. Where there is no necessity imposed on the city of buying back a franchise, the city may be able to furnish the service at a smaller price than the consumer would otherwise pay. Still, such ventures may prove to be failures, in which case the loss will have to be made good out of the proceeds of taxation instead of out of the pocket of private investors as at present. Finally, it is urged that the substitution of public management for private management would disparage that persistent search for economizing expedients and new apparatus, and thus in the domain of urban monopolies might not improbably lead to what John Stuart Mill was fond of describing as "the stationary state."

The advocates of the franchise system ground themselves firmly on the high probability of lower cost of service under private management than under public, and

[1] See article V of Articles in addition to, and amendment of, the Constitution of the United States.

contend that this lower cost in the present, and still more this constantly lowering cost in the future, mean a minimum waste of social capital, and in the long run lower prices to the consumer than direct public service is capable of affording. It is hardly necessary to point out that, in purchasing supplies or in contracting for labor, private self-interest, stimulated by the hope of gain no less than by the fear of loss, will drive a sharper bargain than will public authorities who have nothing particular at stake.

Of even more importance than holding down running expenses to the lowest figure compatible with adequate service is the public gain derived from the solicitous inquiry made by private companies into improved kinds of apparatus and the generally speedy introduction of such improvements. Public officials rendering industrial service to the community may try to palliate the more obvious discomforts attaching to antiquated methods; they are not especially likely to trouble themselves about experimenting with new and promising appliances. The case has been well put recently by an expert in local transportation[1]: "Governments in general, and municipalities in particular, are essentially conservative in trying new things. Private capital, on the contrary, is essentially eager to anticipate the future and preempt all possibilities of profit. Herein lies the real and fundamental reason why municipal ownership and operation of public service enterprises is not, nor ever will be, a success from the broader points of view—from the standpoint of the people's progress."

Before proceeding to ask how far these opposing economic considerations are affected when viewed in the

[1] Mr. Edward E. Higgins, in Municipal Affairs for Sept. 1897.

light of experience, it will be necessary to glance for a minute at the political considerations involved in this issue. The notorious dishonesty of many of our city officials, no less than the prevalence of the spoils system in city politics, would seem at the first blush to create a strong presumption against the public ownership and operation of urban monopolies. But the advocates of this policy fairly take the bull by the horns when they insist that corruption in municipal legislatures is very largely rooted in the present system under which franchises are granted, confirmed, or extended. "Legislative corruption finds its opportunity in this situation." Both the city legislature (the council or the board of aldermen) and the private company needing the franchise are tempted 'beyond that they are able,' the first to sell, the last to buy, the right to use the streets for a consideration which, however satisfactory to the immediate parties to the sale, almost always amounts to a corrupt betrayal of the public interests. Nothing comparable to the legislative corruption in the granting of franchises is to be found, it is contended, in the administration of public water-works, in the street-cleaning service, in the renting of city docks, or in similar public undertakings. Mr. Albert Shaw puts this side of the case in a nutshell where he says[1]: "The wear and tear upon the morals of a weak municipal government are greater by far when it comes to the task of granting franchises—that is to say, of making bargains with private corporations—than when it is attempted to carry out a business undertaking directly on the public account. . . . In the United States the scandals and difficulties attendant upon . . . municipal ownership . . . would not be as great as those involved in making bar

[1] Cf. Symposium in the Independent, May 6, 1897.

gains between municipal governments and the gas trusts and illumination companies, and in the exercise of an alleged public control."

The obvious reply to this presentation of the matter is that to scatter corruption is not necessarily to destroy it; that public ownership and operation will involve *constant* opportunity for dishonesty; and that the moral standard of public officials will not be raised by merely depriving them of the power to grant franchises. Indeed there is much reason to believe that under municipal operation we should find corruption continuous instead of occasional, and efficiency occasional instead of continuous.

Evidence Bearing upon the Two Policies.—It is to be feared that the evidence of statistics and of concrete experience in this matter will tend, as it often does, to confirm pre-existing prejudices rather than to aid suspended judgments to an unbiassed decision. Sometimes it proves the ripest wisdom after the examination of conflicting statistics[1] to doubt them all rather than to ac-

[1] The United States Commissioner of Labor Statistics in conjunction with the heads of similar state bureaus is conducting at this time an investigation into water, gas and electric light plants; and will undertake to ascertain the cost to the producer, and the price to the consumer, of these products under public and private management respectively. This will be the first official report covering the United States that has yet been made.

For the statistical presentation of facts involved, consult Municipal Affairs for March, 1897, which contains a bibliography of works on city government. The same journal for June and September, 1897, contains articles presenting statistical evidence on the points involved. Municipal Ownership: Its fallacy, by M. J. Francisco; the publications of the American Economic Association; Municipal Monopolies and their Management, by A. H. Sinclair; and the Proceedings of the National Association of Officials of Bureau of Labor Statistics in the United States for 1896 may be consulted with profit.

Especially sharp-sighted is Prof. Willcox in his remarks in the last mentioned pamphlet, where, in speaking of the difficulty

cept any. Especially is this the case when there are many complicating factors, some of them peculiar to a given time, place, or form of local government.

The evidence which purports to bear upon the plan of public operation as compared with the franchise system ought to be scrutinized sharply. Not only must comparisons be made of the prices charged the consumer, but the quality of the service rendered and the question of cost must also be investigated. A public gas company which charges the consumer on his gas-bill a dollar per thousand cubic feet, and which runs behind in its current expenses so that it must be aided out of the proceeds of taxation, may obviously be exacting more from the consumer than a private company which charges a dollar and a quarter per thousand cubic feet, pays taxes on its property, and is a going concern. Differences in local conditions also must be borne in mind. The cost of gas obviously depends largely on the price of coal. That in turn depends largely on the geographical situation of the gas plant. So that the same charge which in one place might be regarded as truly exorbitant might elsewhere not cover the actual cost of production.

of obtaining reliable statistical data bearing on the problem, he observes: "Yet, on consideration, it appears that public and private plants do not render the same service except by accident, and hence, assuming that the true cost can be obtained, it would be the cost of different services. The aims of public plants and of private plants are different. The aim of a municipal plant is primarily to satisfy the voters, and in subordination to that to be self-supporting or remunerative. The aim of a private plant is primarily to earn money for the corporation, and in subordination to that to please the patrons. Hence the management of a public plant is tempted to make it appear that the plant is remunerative, by twisting the figures if necessary, and at the same time be lavish with the light, as a means of securing the favor of the voters. On the other hand, the management of a private plant is tempted to keep its financial condition secret, or to represent it unfavorably to the public, in order to prevent competition or municipal interference."

Similarly, the street-car trackage required for a compactly built city like Glasgow is not more than a sixth of that required for a city that spreads out like Brooklyn. Obviously, the difference in capital invested in the plants must be enormous, and differences in price may thus be justified. Besides distinguishing between the real and the nominal prices charged to consumers, and after making some rough allowances for differences in local conditions, we must assure ourselves, if we would profitably compare public with private prices, that the system of accounting is essentially the same in both. Unfortunately this is seldom the case. If language was invented, as the cynic said, to conceal thought, the language of municipal book-keeping is certainly eloquent. The loss which occurs to the city by foregoing the taxes which would be paid on a private company's plant seldom troubles the municipal accountant. The risk in which the city government is involved by the possibility of having to give up the business by reason of failing therein never clouds the horizon of the city management.[1] Still allowance for interest on the indebtedness incurred in building the city plant is being made in an increasing number of public reports. Gratifying as this concession is to sound finance, it is still a melancholy reflection that the allowance made in municipal accounts for annual repairs, replacements, and contingencies still excites either the wrath or the derision of the advocates of the franchise system. The differences in two systems of accounting are sometimes very considerable. For ex-

[1] This is not a purely theoretical risk. Several of our American cities have been compelled after a public trial to betake themselves to the franchise system. A private company will properly take the element of risk into account. Thus a private company once offered to light Detroit at $124 per lamp per year if they were given a three year contract, and at $102 per lamp per year on a ten year contract.

ample, the Mayor of Philadelphia recently reported to the City Council an annual net profit on the city gas-works of $1,600,000. A committee of the Massachusetts legislature at the same time investigated the Philadelphia plant and reported back that the city was losing by it $100,000 a year. Recent developments would seem to show that the committee was much nearer the truth than the Mayor.

A careful sifting of the evidence presented on both sides seems to establish the following conclusions as highly probable: (1) The price charged by private companies for the supply of water exceeds by twenty-five to forty-three per cent. the price charged by municipal water-works [1]; (2) the cost of the water-supply by municipalities probably exceeds the cost incurred by private companies, though how far the increased cost augments general taxes it is difficult to say; (3) while the price of gas in England under both systems is markedly less than the price of gas under either system in the United States,[2] the rate of reduction in gas prices in the United States since 1870 seems to have been more rapid than in England [3]; (4) the cost of producing gas has probably been less under private than under public management. At all events in England the private companies have constructed their plants on the average at a lower cost, have produced more gas from the average ton of coal consumed, and have delivered a slightly

[1] Cf. Conkling, City Government in the United States, pp. 95 and 187; Sinclair, Municipal Monopolies and their Management, pp. 28, 29; also Baker, Manual of American Water Works.

[2] The American Gas Light Journal for Nov. 1, 1897, gives the average per capita consumption in England as 4245 cu. ft.; the average per capita consumption in the United States as 1770 cu. ft.

[3] Cf. Municipal Affairs for 1897, p. 283; also the Reports of the Board of Gas and Electric Light Commissions of Massachusetts.

larger percentage of the total amount of gas manufactured than the local authorities have been able to do. Still, in 1889 the expense per thousand cubic feet manufactured by private companies in England was slightly in excess of the expense similarly incurred by the public companies [1]—a difference which conservative accounting may possibly explain. It is practically certain that municipalities have paid more than private companies for labor both in England and in the United States. "This failing," says Professor Bemis naïvely, "if it be a failing, is quite common in public works. Many consider it an advantage for public works thus to set the example of good wages." [2] Our complacency on this score might perhaps be just if the example set by our public works were uniformly an example of good wages for good work. When, as is so common, the practice of our public works amounts to high pay for the inefficient service of party hacks, the "advantage" of such a policy is more than dubious; (5) the price charged for gas by public companies in England appears to be less by seven or eight per cent. than the charge made by private companies, but no such general assertion can be made with respect in the United States; (6) public electric light plants in this country cannot be said generally to furnish electricity at a lower cost or price than private companies. The evidence rather tends to show that the advantage lies with private companies, especially as long as electrical apparatus is evidently in the transitional stage; (7) local transportation has been undertaken by several British municipalities with varying success. In this country it is as yet untried. When all circumstances

[1] Cf. Sinclair, *op. cit.*, p. 30.
[2] Publications of the American Economic Association, 1891, p. 78.

are taken into consideration it would appear that our transportation service is not only immeasurably more efficient than the British tramway service, but that the charges for distance traversed are really less in the United States than upon the most successful of municipal lines in Great Britain.[1]

The generalizations which may be drawn from this summary are that cost is almost certain to be less under a private company than under city management; that the price charged the consumer *may be* less under municipal public works, but that there is no assurance that this *will be* the case; that efficiency of service is likely to be greater under a private system where improvements are rapidly introduced than under a public system where they are slowly adopted. When to these tentative conclusions we add that the largest experiment in municipal industries in the United States, the Philadelphia gas-works, after an experience of over half a century has proved an unquestioned financial failure, the presumption against direct municipal service in this country at the present time gathers great strength. Political conditions being what they are, it seems fairly safe to assert that the city taxpayer would probably be hit harder by public waste and public stealing than by private profits. Obviously, the conclusion drawn is favorable to the franchise system rather than to a system of municipal industry.

It is requisite under a franchise system to secure to the city the full value of the privileges granted, and at the same time so to shape the franchise that under it the service afforded shall be as efficient and as low-priced as possible. This task is one of detail where local

[1] Cf. Municipal Affairs, 1897, p. 483.

conditions may often properly be taken into account. Certain general principles there are, however, which ought to be observed. Evidently the longer the period for which the franchise is granted, the less will be the annual charge imposed on the company for the risk it runs of finding its plant an elephant on its hands. In other words, the assured duration of the franchise acts as a sort of insurance against lack of employment for the capital invested. The more exclusive are the privileges accorded the company by the franchise, the less will be the dread of the competition of rivals. Hence this insurance against future competition ought still farther to lessen the company's risks. While, therefore, it may be unwise public policy to grant perpetual franchises, "all inclusive and exclusive," the public interest is undoubtedly furthered by minimizing the risks which attend the investment of private capital in a public service industry. There is much to commend in the policy of selling franchises at auction every twenty-five years for a certain percentage of the gross receipts. Theoretically, a certain percentage of the net profits would be better still, as they more nearly measure the annual value of the franchise. But the item net profits can be juggled with, whereas the item gross receipts is 'of no private interpretation'; and this is a case where clearness and certainty are to be preferred to theoretical equity. There may be some force in the contention that selling franchises by auction increases the expenses of the operating company, and thus tends to keep prices high or service poor. But it must be remembered on the other hand that so far as public service industries are analogous to monopolies the tax will be difficult to shift. Moreover, if the franchise is absolutely untaxed, or is given away instead of auctioned off, there is every reason to believe

that the prices charged will be set with exclusive regard to corporate profits.[1]

Financial Conclusions.—The real issue in the matter of the state's quasi-economic income centres in the proposal to extend the state's industrial functions. Such a policy is advocated not merely on financial grounds; it is urged on social and economic grounds as well. It is a problem to whose solution mere watchwords can contribute nothing. The bugaboo of socialism rouses the fears of the ordinary citizen as little as the shibboleth of *laissez faire* rouses his enthusiasm. So that it would be nothing surprising if the experiment of the municipal ownership and operation of industries were tried in the United States on a large scale within the next two decades.

It is indeed not impossible that a policy of municipal industries may become in the future far less hazardous than it would be at present. There may be a more pervasive interest in our city politics. The extension of the competitive civil service system may contribute its aid to this desirable end. Public policy, after all, is relative to conditions of time and place, and, provided responsibility for industrial mismanagement can be definitely located, the municipal experiment may be tried under fairly favorable conditions. Hardly as much can be said for the possible success of a policy of federal experimentation.

[1] Where a street-car company or a gas company cannot lawfully exceed a certain price for the service afforded, a tax imposed on the franchise may be partly shifted by impairing the quality of the service rendered unless this be prevented by the city. Street cars may be crowded, or the candle-power of gas lessened. This possibility serves to differentiate the case from the abstract case of a tax on monopoly profits. The implied assumption there was that the quality of the product would remain constant, and that if it deteriorated the demand at the former price level would fall off.

In any case it is fair to assume that only where the industry is an actual monopoly is the state warranted in entering the industrial lists. Jevons[1] has given the characteristics of the monopoly whose business the government may undertake with least danger. It is operated on a few routine principles, as is the post-office. It supplies a permanent and widespread want, as does the water supply. Its administration is under the public eye. The amount of capital required is not excessive,—this to render misleading accounting impossible. Its technical apparatus is no longer in the experimental stage, unlike the electric apparatus of today. Professor Hadley acutely criticises this summary by saying it is restrictive rather than positive, indicating where the risk of government experiment will be least rather than where government industry will be absolutely superior to private enterprise. Still, to a community bent on experimenting, Jevons's criteria may be helpful. The experiment may be foolish or ill-timed or dangerous, but even among such experiments there are some less hazardous than others.

It has already been indicated what latitude the government has in setting prices upon its services. The private concern knows that its sales must in the long run cover its expenses. The public concern knows a higher law than that of cost, and can make good a deficit out of the proceeds of taxation. Evidently, the government may set its prices below cost, at cost, or (where it asserts for itself a monopoly) as much above cost as it pleases.

[1] Methods of Social Reform, p. 297. Cf. also Hadley, Economics, p. 397, who adds another desirable criterion, viz., that the industry be one like the supply of gas, of whose services the city government largely avails itself. This will secure a due regard for quality and cost of production as well as for the price to the private consumer.

Where the service rendered is purely or dominantly political, a necessary function, such as the protection of life or property, or the furnishing of education in the public schools, the question of price does not arise. The necessary services of the state must be gratuitous and must be paid for out of taxation.

The same may be said of those 'optional' public services which are warranted by public utility rather than by absolute political necessity, but which cannot be split up and imputed with any definiteness to individuals. Such, for example, is the maintenance of lighthouses by the federal government, or the lighting of the streets by a city government. Expense incurred for such services must be met by general taxation.

Where, on the other hand, the service rendered is in character like that of the supply of gas or water, where the special benefits derived by individuals are measurable, numerically comparable, and specifically imputable, the principle of cost should regulate the price charged by the public industry. Cost, of course, ought to cover all charges, fixed as well as current, such as are ordinarily allowed for in a similar private concern. Cost may properly cover an annual amount necessary to wipe out the principal of the public debt incurred on account of the public plant. But no margin for clear profit ought to enter into the fixation of such prices. The government has no interest distinct from that of its citizens to justify it in making a commercial profit from the services it renders. Nor can such procedure be justified on the ground that the profit so obtained may be applied to lessen ordinary taxes. If there is any good ground for a public gas plant, for example, it is because that plant can furnish gas at a lower price than a private concern will. If the public plant can do this, it ought to be

willing to show that it can do so by setting prices merely high enough to cover cost. The aggregate of taxation is the same whether a larger or smaller part of it be collected as taxes or as gas-bills; and a clear-cut distinction between what the citizen pays for taxes and what he pays for gas will prevent any hocus-pocus by which he is often hopelessly befuddled as to what he pays for either. It is small consolation when one pays a high price for poor municipal gas to be assured that he is thereby paying part of his taxes; especially when one afterwards learns that in reality the case was just reversed, and that, instead of his gas-bill covering a part of his taxes, his tax bill covered a part of the cost of his gas.

PART III.

TREASURY MANAGEMENT.

CHAPTER I.

GOVERNMENT BORROWING, OR PUBLIC CREDIT.

The War-chest Policy.—Second only to the necessity of furnishing the government with money, is the necessity of furnishing this money within the period in which the government needs it. Roughly speaking, the ordinary yield of taxes about suffices to pay for the ordinary requirements we make of our public servants. But this is not always the case. Industrial depression, for example, may cause the revenues temporarily to shrink, just as unusual undertakings, such as war, may suddenly multiply expenses. Either event will put the government in the strait of not having sufficient means to meet the special needs that have arisen. To be sure, the opposite situation sometimes confronts us, but more rarely. Redundant revenue may result from booming trade, or from the re-establishment of peace. But the notorious prodigality of governments has prevented any very prolonged embarrassments from surpluses. It is the deficit, actual or threatened, which generally occasions the gravest financial concern.

From one point of view the state runs into debt for much the same reason as the individual does. The pri-

vate citizen as a general rule must earn enough each year to pay his year's bills. Still, various accidents, such as sickness or slack trade, may plunge him into debt. But there is this difference between the state and the individual: the state cannot speedily increase its income, as the individual with good fortune may sometimes do. The mere belating necessity for legislative sanction to raise more money or to spend less, as well as the tardiness of most new tax laws to yield revenue, will explain this difference between the problems which respectively confront the public financier and the domestic economist. Unless, therefore, the government keep a store or horde in reserve for emergencies, it will be unable at a pinch to get the money it requires, unless it can borrow. As a matter of fact modern governments do borrow. The sovereign doffs his gaudy trim of sovereignty, and with hat in hand enters the waiting-room of the private capitalist alongside of other humbler applicants for loans. It is by these private capitalists, most of them the subjects of the state, as public law with unconscious irony calls them, that the credit of the borrowing government is gauged and the terms upon which it can obtain loans is determined. Credit, whether public or private, may be defined as the power to obtain capital by a promise of some counter service or payment in the future. It is the nature of the state's power thus to obtain capital that we are to discuss in this place; but before entering upon that subject we may clear the way by briefly disposing of the alternative to public borrowing, that is, the policy of keeping a reserve or a "war-chest," as it is sometimes called, to meet a sudden fiscal emergency. The objections to this policy of keeping a reserve fund for use in time of need are very strong. In the first place, the extraordinary expenses occasioned

by modern wars are so vast that no nation could or would submit to making the necessary sacrifices required to collect a reserve even approximately equal to meeting the war's probable cost, especially if an enormous contingent indemnity to the victor were included in the estimate. To advise a nation to avoid a war debt by keeping a war-chest is much like advising an individual to avoid penury by always keeping a shilling in his pocket. In the next place the time of the occurrence of extraordinary need cannot be calculated. The maintenance of a huge reserve entails a certain and present sacrifice to meet an uncertain and remote danger. If the reserve be kept in the form of coin, the buried treasure subtracts just so much from the nation's circulating medium. The Germans alone of modern people pursue this policy. They have not yet learned the Horatian warning:

Nullus argento color est avaris
Abdito terris . . .

If the war reserve be in the form of securities, the state runs the risk of their depreciation and the danger of having to unload them on a falling market in case of need. Besides, if the interest on such securities is used to meet every-day expenses, the sale of the securities will necessitate a new provision for the wants which the vanished income of the securities no longer provides for. The danger which some insist inheres in the war reserve policy of affording the government the power of initiative in hastily precipitating a struggle has probably been exaggerated, for modern wars are most frequently forced by the people upon a reluctant government. Indeed about the only intelligent defence that can be made of the war reserve policy under modern conditions is, not that it obviates a war debt, but that it renders easy the

transition to a state of hostilities by putting at the ready disposal of the government the sinews of war for the beginning of a conflict. In general, then, the policy of the war-chest may be pronounced unwise and ineffectual. These reserves are not large enough to begin to cover the cost of war; they do not obviate a war debt; they involve a certain loss without affording any guarantee of adequate protection when the uncertain hour of need has struck. Moreover, their infrequent occurrence at the present time warrants us in passing over them lightly, and in taking up the unattractive but inevitable alternative of public borrowing and public debts.

Peculiarities of Government Borrowing.—Ever since Adam Smith writers in describing the peculiarities of public as contrasted with private borrowing have insisted upon certain pre-conditions which must exist before states can borrow money. These pre-conditions appear to be two in number. First, there must exist a money-market where capital is to be had in exchange for a pledge of future counter service or repayment. The obvious necessity of a money-market might go without mention were it not wise to insist that the money-market in its modern form is historically coeval with the appearance and political power of the commercial classes, and dates back only two centuries in modern Europe. The other necessary prerequisite according to most financial writers is political in its nature rather than economic, and consists in some adequate security to assure the lender of the fulfilment by the state of the promises it makes when the loan is contracted. This security is thought to consist substantially in the power and influence exerted by the propertied classes upon legislatures to prevent them from repudiating public obligations. The public creditor, Professor Adams contends, prac-

tically lends to a corporation (the government) controlled by himself, or by the class he belongs to. The germ of this idea of "commercial constitutionalism" appears in the "Wealth of Nations."[1] "The same commercial state of society," says Adam Smith, "which, by the operation of moral causes, brings government in this manner into the necessity of borrowing, produces in the subjects both an ability and an inclination to lend. If it commonly brings along with it the necessity of borrowing, it likewise brings along with it the facility of doing so." While a money-market and some political security against repudiation must unquestionably underlie government borrowing, it seems likely, as Bastable[2] remarks, that the "mere existence of constitutional rule does not suffice to create borrowing, nor its absence to stop it, as the French debt of the eighteenth century and that of Russia at present will suffice to prove." The hostility of late years manifested in the United States against the increase of the federal bonded indebtedness except for war purposes, and our general acquiescence in the wisdom of expunging public debts in time of peace, seem both of them to qualify the conclusions drawn of the inevitable connection between constitutional rule and public debts.[3] The essential peculiarities

[1] Vol. II., Bk. V., p. 509 (*Thorold Rogers'* edition).

[2] Public Finance, p. 579.

[3] The most illuminating depiction of the evolution of state borrowing appears in Cohn's *National Oekonomie* (Vol. II., p. 707 *sq.*). He points out how (1) the security afforded by the borrowing state has changed from an objective material pledge, such as territory, to the general reputation modern states have acquired for financial trustworthiness; (2) how formerly states could borrow only for short time periods, whereas now they can borrow in perpetuity, if necessary; (3) how the occasion for borrowing is no longer a simple lack of resources, but unusual expenses especially for public industries which in time will be defrayed by public industrial earnings and by normal revenue; (4) how forced loans are being replaced by voluntary

of state borrowing as compared with borrowing by individuals are but two in number: first, the unique legal status of the state which borrows; and second, the unique effect produced by the state's fulfilment of its financial obligations to its creditors. It will hardly do, as Bastable would have us believe, to elevate into this category of salient characteristics of public borrowing the difficulty states find in avoiding debt. Many private individuals, if we are to judge by their conduct, experience a similar difficulty. Nor does any generic difference arise from the fact that the state is, as Leroy-Beaulieu puts it, an *être imperissable*. States are mortal no less than men, and private corporations are often longer lived than governments.

First, then, the borrowing state is unlike an ordinary debtor in that the state is sovereign, and cannot against its will be forced to observe its bargain with its creditor. It may repudiate without having to abscond; it may default and not fail. Our commonwealth governments cannot be forced against their will to observe their financial obligations. Some of them have repudiated their debts more than once. The minor units of government, however, such as incorporated cities, can generally be cited into court by private persons and made to fulfil their contracts. This peculiar legal status of governments loses much of its importance from the fact that while no legal remedies may be at the command of the public creditor, there is an economic sanction which the legal sovereign cannot escape. This sanction is the actual or anticipated refusal of the private capitalist to lend

loans; (5) how adventitious inducements such as lotteries are no longer necessary to cajole capitalists into proffering their capital to the state; and (6) how special organs of *haute finance*, such as the Rothschilds' houses, have been evolved to take and place the securities a state issues when it contracts a loan.

again to a defaulting government, or, if at all, only at such rates of interest as will insure him against any hazard of future bad faith on the part of the state. Indeed it seems that the legal sovereignty of debtor states, so long as it has mirrored any part of their actual power to repudiate, has warranted and compelled private capitalists to charge higher rates of interest on public loans than otherwise would have been exacted. It is only when the power to repudiate has been renounced, to all intents and purposes, that a state can borrow on the most advantageous terms. The real significance of sovereignty from a financial standpoint is mostly historical, and consists in the record of how governments have learned by experience that honesty is the best policy. So far as sovereignty is operative in the actual world of finance, it is mainly as an element of risk which the capitalist may think it worth his while to consider in offering to loan capital to a semi-civilized or a semi-honest government.

The second unique factor about public borrowing is the effect produced by the state's fulfilment of its obligations to its creditors. When a loan is contracted between two private parties the payment of interest is made for the use of borrowed capital. The use of such borrowed capital generally results in gain to the borrower as well as to the lender. The capital is invested ordinarily in some business enterprise and is the ground of the profits out of which the interest is paid. Where this is not the case the payment of interest must eventually cease. Normally, therefore, the payment of interest by one individual to another connotes a mutual benefit, as well as an industrial service to society at large. The payment of interest by the state to its bond-holders often, though not always, connotes, not a public benefit, but a

public sacrifice. The state may be paying its creditors interest upon a loan of capital where the actual capital borrowed was destroyed years ago in prosecuting a war, or wasted outright in some industrial venture. Such interest payments are made (except where there may be productive public property, such as railroads operated at a profit) by taxing the state's citizens. The bond-holder's income in such cases is simply taken from the taxpayers' pockets. Sometimes, it is true, the results of a war have been so beneficial to a nation that the interest paid to those who furnished the capital for the war is more than made up for by the advantages the taxpayers at present enjoy. But war, unlike industry, is a game at which only one party can win, and at which, if we consider everything, both parties not infrequently lose. So that in general the statement must stand that the payment of interest or the repayment of the principal to the public creditor implies a synchronous sacrifice on the part of the taxpayer instead of a mutual benefit, as in the case of ordinary industrial loans. This must not be taken, of course, as any justification for repudiation, but simply as a colorless picture of the actual operation of public debts. The evils inherent in the system would be enhanced, not abated, by a policy of repudiation. The payment of interest to the public creditor, however, differs from the analogous transaction between private persons in this also, that, barring any attempt at repudiation and assuming a strong government, interest on the public debt is much more certain to be paid than on a private loan. The ability of a railroad to pay dividends on its stock will depend on that particular railroad's earnings. If these shrink, the dividends will be passed. Not so with the interest on the public debt. Depending as it does on the proceeds of taxation, the bond-holder is as-

sured of his income so long as the tax-gatherer is sure of his harvest. This is one reason for the low rate at which governments often borrow, that the security they offer is largely independent of the state of any particular industry, and depends on industry in general. The broad base upon which the borrowing power of the state rests is without question the most significant feature of public credit. Public debts are thus in essence a lien upon the income of the taxpayers.

Since the interest payments made by the state, as well as the repayment of the principal of public debts, must eventually fall upon the taxpayers, the question may naturally arise,—why not resort to taxes at the very outset, instead of borrowing first and taxing afterwards? Some such suggestion is not infrequently made, especially at the beginning of a war, when the subject of ways and means comes up for discussion. If it were possible to obtain the requisite amount of capital by suddenly increasing taxes, and if such an unexpected increase of taxes could be borne by the community without serious protest, there might be much to say in favor of a policy of taxation and against a policy of loans. Unfortunately the yield of new taxes is uncertain and often tardy, and popular repugnance to a sudden violent increase of taxation makes necessary the use of both loans and higher taxes to meet such fiscal emergencies as war.[1] If, however, the plan of defraying all war expenses by taxation is extreme in its severity and practically impossible, the opposite policy of attempting to raise all supplies by borrowing is as dangerous as it is alluring. This exclu-

[1] There is also some truth in the statement that if the entire cost of war were borne during the war by taxes, certain income recipients who profit by the war would be absolved in future from paying any part of the cost of the conflict whose benefit they share.

sive reliance on loans was tried by us in the revolutionary war, with the result that the general government went bankrupt. It was essayed in the beginning of the war of 1812, and to a certain extent in the civil war,[1] and again in both instances the credit of the government fell, its obligations were sold at a discount, and the debt incurred was vastly in excess of what was actually necessary. Sane financial policy in time of war requires that capital be obtained at the outset by borrowing, and that additional taxes be at once imposed to meet the additional interest charge thereafter to be borne by the government on account of the increased debt. Sound policy also requires that at least a part of the extra capital needed be raised by taxing the present age instead of unduly burdening future generations. The reason why a reliance wholly upon loans fails as a financial resource in time of war is this: Buyers of government bonds want to be assured of an annual income regularly paid. This income the state can secure with certainty for its creditors—the bond-holders—only through the agency of taxation. If instead of resorting to taxes the state trusts to future loans out of which to pay the interest guaranteed on the loans already made, future buyers of bonds will be chary of an investment whose yield is so uncertain. Either they will not buy bonds at all, or only at a discount, or they will exact exorbitant rates of interest. On the other hand, the policy of attempting to meet all the extraordinary expenses of war by means of current taxation has never been successful on any great scale. Even in England, where the willingness and ability to follow such a plan have been greater than elsewhere, two thirds of the costs of her wars since 1688 have been

[1] Cf. H. C. Adams, Public Finance, p. 133 *sq.*

provided for by borrowing, and but one third by enhanced taxes.[1]

Effect of Government Borrowing.—Ever since states began to pile up public debts the policy of resorting to public credit has been discussed by publicists and economists with singularly little unanimity of opinion. Head-shakings have characterized the wise and prudent who prophesied certain disaster from the loan policy, while others, regarding mainly the concomitant growth of national industry, have boldly declared that public debts were as desirable as gold mines, and that a national debt was a national blessing. More judicious observers have attempted to steer a middle course, and have drawn up lists of objects for whose attainment the creation of public debt is justifiable.[2] Such lists, however, go a very little way in solving the riddle. Indeed, it is doubtful whether any formula can prove in this matter of much real assistance. When it is remembered that the payments made to the public creditor come from current taxation, the common sense test of state borrowing will consist in weighing well the benefits accrued and accruing from the proceeds of any concrete loan, with the sacrifices (taxes) which the loan in question has caused. Such benefits are often very imperfectly measurable in money terms. Indeed, there is but one generic case where the advantage of public borrowing can be proved in black and white. Where the loan has been made to construct public works of general utility, water-works for example, for whose services charges are imposed, and where the plant has proved to be financially successful as well as mechanically efficient, the success of the

[1] Leroy-Beaulieu, Science des Finances, II., p. 258 *sq.*

[2] H. C. Adams, Public Debts, p. 78, mentions temporary deficits, war, and public works, as justifying a resort to the loan policy.

loan can hardly be questioned. On the other hand, where the government borrows to construct or acquire property whose usufruct is enjoyed without any specific charge to the citizens, the wisdom of the loan policy must be gauged by the estimate we place upon the advantages obtained from the property in question. Money estimates fail almost altogether when we try to judge of the wisdom of a policy of selling bonds to acquire parks, improve highways, or build iron-clads. So long as men differ in opinion upon questions of public policy, so long will they differ upon the utility of specific public loans. Where the result of public borrowing is not only not measured in dollars and cents, but where the result of such borrowing is partly or wholly intangible and immaterial, the difficulty of pronouncing an enlightened judgment is immensely enhanced. Take for example the case of public borrowing for educational purposes, such as the building of high schools or their equipment. Can we be absolutely certain that the education imparted will result in such mental training as to compensate wholly for the sacrifices entailed by the heavy taxes paid on the school bonds? If the plant and equipment have been bought at a fair price, and are not disproportionate to the needs of the community, there are perhaps few who would dispute the wisdom of the loan. But, to take another case, where recourse to public credit has been necessary to preserve the national life or honor, there are few rash enough to lament the cost of the loan policy. There are times when neither the state nor the individual can stop to count the cost. But we are much too prone to assume that war loans have been necessitated by such lofty and ideal motives. There is more than a grain of truth in Ruskin's bitterly ironical depiction of a public debt. A civilized nation, says Ruskin in *Fors*, "in modern

Europe consists essentially of (*a*) a mass of half-taught, discontented, and mostly penniless populace calling itself the people; of (*b*) a thing which calls itself a government —meaning an apparatus for collecting and spending money; and (*c*) a small number of capitalists, many of them rogues and most of them stupid persons, who have no idea of any object of human existence other than money-making, gambling, or champagne-bibbing. A certain quantity of literary men, saying anything they can get paid to say,—of clergymen saying anything they have been taught to say,—of natural philosophers saying anything that comes into their heads,—and of nobility saying nothing at all, combine in disguising the action, and perfecting the disorganization, of the mass; but with respect to practical business the civilized nation consists broadly of mob, money-collecting machine, and capitalist.

"Now when this civilized mob wants to spend money for any profitless or mischievous purposes—fireworks, illuminations, battles, driving about from place to place, or what not,—being itself penniless, it sets its money-collecting machine to borrow the sum needful for these amusements from the civilized capitalist.

"The civilized capitalist lends the money on condition that, through the money-collecting machine, he may tax the civilized mob thenceforward forever. The civilized mob spends the money forthwith in gunpowder, infernal machines, masquerade dresses, new boulevards, or anything else it has set its idiotic mind on for the moment; and appoints its money-collecting machine to collect a daily tax from its children, and children's children, to be paid to the capitalists from whom it had received the accommodation thenceforward forever.

"That is the nature of a National Debt."

The primary effect of public debts is heavier taxes, but there are certain collateral effects of public borrowing that cannot be dismissed without a word of comment. First in order comes the effect of public borrowing upon industry in general. When the state enters the money-market it bids for the control of some of the capital which hitherto has been offered by private capitalists to each other. The state's control of a part of the loan fund lessens the amount available for use in private industry, and will often result in driving up the rate of interest. The more capital the state absorbs, the less will there be left ordinarily for private persons to control and use, unless foreigners come forward and throw their capital upon the market. In case the government uses its loans exclusively for some purely commercial or industrial purpose, such as the acquisition, construction, or operation of railroads, and in case it successfully manages the industry in question, the effect upon the real income of the people will not be great. What private enterprise has hitherto done the state now manages successfully; and, barring the difficulty of the transition from private to public ownership, the result has not been of great moment. The rate of interest may not be permanently affected, as the capital thereafter controlled by private concerns may suffice for the narrowed industrial field to which they have been restricted. When, however, we remember that the government borrows as frequently for war or armament as for industrial ventures, and is so unlikely to succeed in the latter, the conclusion is inevitable that government borrowing is likely to raise the rate of interest. The supply of consumable commodities is likely to be reduced on account of the smaller amount of capital employed in their production, and the price level is likely to rise in the long

run for the same reason. Some compensating effects arise from the greater energy exerted under the stimulus of necessity, and the more efficient utilization of what capital remains available for private industry, but the real incomes of all classes except the capitalists and the speculators are likely to fall because of the curtailed supply of necessities and comforts. One cannot eat his cake and have it too; and if a nation increases its force of soldiers and sailors, it must decrease the number of its farmers and mechanics; if it spends more on gunpowder and guns, it must spend less on bread and butter. There will be numerous exceptions to this general rule. Army contractors will obviously wax fat. The time of war may coincide with a period of industrial revival. Work may be plenty; discontent may be hushed. But until there is a safe way found to get something for nothing, we may rest surely in the conviction that much of the apparent prosperity has no real or lasting foundation, that the rise in prices, especially if irredeemable paper money has been emitted, is purely nominal, and that our fool's paradise will prove eventually a house of cards.

Besides the industrial effects of a public loan policy there are certain political and social influences springing from the same source. Obviously, a man must have capital—must even be a capitalist on a small scale—before he can lend money to the government, so that public borrowing cannot be charged with creating a distinct class in the community whose interests are not at one with those of society. But the assured income from such loans to the public, it is maintained, absolves the public creditor from the necessity or inclination thereafter of working for his living, and keeping in healthy touch with his industrial environment. So, too, it is asserted that the payment of the bond-holder and the extinction

of the public debt will convert this formerly torpid class into active men of business and imbue them with a solicitous concern for investing in some kind of productive industry the capital which the state has returned to them.

> "The bond, a beggar now,
> Seeks investment anyhow,
> Anywhere."

It is hardly likely that this is altogether the case. Suppose that a definite amount of the nation's property were turned over to the bondholders in full satisfaction of their claims upon the state. In so far as this property is in the shape of lands and houses, the public creditors might use, occupy, or let them; in so far as the property transferred is in the shape of industrial capital, it seems not unlikely that the entrepreneurs (if we may assume for a minute that they are totally distinct from the bondholding class) would still control this capital, and pay interest for its use to its owners, the ex-bond-holders, rather than as formerly to the state as an intermediary agent collecting the bond-holders' interest under the guise of taxes. Indeed the influence of public borrowing in creating a class of capitalists is *nil;* its influence in perpetuating such a class is not very much greater. Much stress is laid by some writers on the stimulus given to saving by affording the opportunity to invest in public securities. But here again we may doubt the extent of such an influence. It is not very likely that a man who will not save to invest in a savings-bank which he has seen will save to lend to a government which he has not seen.

Lastly, there is a political influence exerted by the loan policy, though publicists are hardly agreed on the exact nature of this influence. Professor H. C. Adams [1] thinks

[1] Public Debts, pp. 22, 23.

that government borrowing tends to weaken public control over the purse by allowing legislatures to embark on ventures whose cost would prove a deterrent if the cost had to be met by the immediate imposition of taxes, and argues that any method of procedure "which allows the government to enter upon any great enterprise without bringing the fact fairly to the knowledge of the public must work against the realization of the constitutional idea." Before the imposition of constitutional checks upon the powers of state legislatures to borrow on the public credit, there was much to be said for this aspect of the case. But the danger that the public credit will be employed surreptitiously in future is a vanishing danger in the United States. The state legislatures fortunately are hampered now by constitutional amendments from taking such a course; and the public keeps a sharp lookout on any proposal by Congress to authorize the issue of bonds. Indeed it is far more likely that the chief political effect produced by federal borrowing is to attach more firmly to the federal government the interests of the public creditors who, it is to be feared, may exert in time an influence on that body to prolong the public debt beyond the limit dictated by general expediency.[1]

The Technique of Public Borrowing. — An intelligent apprehension of the subject of public credit involves, in addition to an understanding of the peculiar nature and effects of government loans, some knowledge of the technical handling of public debts. This will embrace a description of the various forms or classes of public debts; of the way in which they are negotiated or sold;

[1] Leroy-Beaulieu, Science des Finances, Vol. II., p. 309, speaks of "l'habitude en France si invétérée de sacrifier les contribuables aux rentiers."

of their conversion or exchange for other evidences of indebtedness; and of their ultimate redemption or extinction.

(*a*) *Classification of Public Debts.*—Public debts may be classified in several ways. The commonest classification divides such debts into funded and unfunded or floating debts. Funded debts are such as have been formerly acknowledged by the government and whose interest is regularly provided for by law. The name was applied because the interest due the holders of such debts in England was originally paid out in certain specified funds or taxes. The funded debt exists ordinarily in the shape of bonds or annuities. Unfunded or floating debts consist often of various unpaid accounts charged against the state for supplies furnished or services rendered to the government or its agents. These debts are largely current outstanding accounts which, though unpaid, ordinarily draw no interest. The holders of such claims against the government sometimes are allowed to exchange them for evidences of the state's funded debt. The funded debt of the United States is in the form of bonds, either registered at the Treasury with the name of the owner, or in the owner's hands in the shape of coupon bonds. The government remits the interest direct to the owners of the registered bonds, and cashes the coupons of the other class of bonds as these coupons mature. Unfunded debts often are rolled up when the government purchases supplies with great rapidity and in great quantities, and omits to make immediate payment. Thus after our late Civil War the unfunded debt was in excess of $1,000,000,000. Unfunded debts in the past have often been incurred by American cities where the city officials without legal warrant have purchased goods and given the seller an acknowledgment of the

debt. It is needless to say that sound finance discountenances such a lawless policy.

But public debts may be classified not only on the basis of the absence or presence of formal provisions for the regular payment of the interest thereupon, but also with reference to the time they have to run before the state's obligation to pay the principal of the debt becomes due. The bonds of the United States, of the commonwealths, and of the smaller civil divisions generally mature at certain definite dates. The federal government has the option of repaying at will the principal of a small part of its debt; upon the greater part it may repay the principal after a certain specified term. The greater part of the funded public debt of other nations is in the form of what is known as "perpetual debt." This does not imply that the debt is to exist for all time, but simply that foreign governments guarantee their creditors only an annual income, called an annuity, or *rente*, without any definite promise ever to repay the principal. These foreign governments, however, generally reserve the right to repay the principal whenever they see fit, provided always they have the money requisite for the purpose. In addition to the typical American form of public debts maturing at some future time, there are other forms employed by continental states. In return for the capital they borrow they sometimes guarantee annuities which terminate with the death of the annuitant, or at the end of a given term of years. Sometimes, moreover, they issue bonds whose repayment is determined by periodical drawings, the bonds being put into classes, and a certain number being selected by lot from time to time for repayment.[1]

Lastly, public debts are often classified as interest

[1] Leroy-Beaulieu, Science des Finances, Vol. II., p. 299.

bearing and those bearing no interest. This distinction is of service, not in contrasting the funded with the floating debt, but in dividing off the funded debt from such government promises which circulate as money[1] and are often endowed with the prerogative of serving as a legal tender in payment of debts between individuals. Such government promises to pay coin to the bearer do not ordinarily bear interest. They purport to be redeemable in coin on presentation, and are often so redeemed. This form of public debt is unique in a number of ways, owing mainly to the fact that such evidences of the public debt pass ordinarily from hand to hand and serve as a common medium of exchange. When a government pays out such promises in the purchase of supplies or in the payment of official salaries, such promises will be accepted in ordinary domestic commercial dealings so long as there is no distrust of the government's ability and willingness to redeem them in coin at their face value on presentation. By increasing the amount of the currency these notes tend to raise the general price level and to drive out of circulation an approximately equivalent amount of coin which is melted down, exported, or hoarded away. When all the standard coin has been displaced, or even before, if discredit attaches to these notes, they will depreciate in purchasing power, and their value thenceforward will depend partly on their quantity and partly on the estimate the commercial world makes of the remoteness of their redemption in coin. The apparent gain which is derived from saving the interest on the public debt bearing no interest is generally offset by the depression of public credit

[1] Besides bonds and annuities, some governments borrow money for short time periods, usually not longer than a year, by emitting interest bearing treasury notes or exchequer bills. These do not circulate as currency, however. See p. 371, *note.*

thus caused, the higher rate of interest exacted in consequence by the purchasers of government bonds, and more than all else by the element of uncertainty introduced into commercial dealings by a disordered paper currency. They have proved the most costly as they are unquestionably the most insidious form of public debts. Even after the exigency which called them forth has passed away, they often remain for years to vex and harass industry and commerce, and their restored parity with the coin they ostensibly represent can be secured only when there occurs a fortuitous conjunction of such events as budgetary equilibrium, a favorable current of foreign trade, and a return of legislative sanity. Their discussion, however, belongs more properly to the subject of money and banking than to finance proper.

(*b*) *Negotiation of Public Debts.* — Various questions of detail arise when once it is determined that a government is to borrow money by the sale of its securities. The placing of such loans has been undertaken at times by banks or brokers who have acted as the government's agents. More recent experience seems to demonstrate the ability of the federal government to serve itself in this matter. Prudence, tact, and business methods generally enable the Treasury to advertise and place its loans with less expense than would be involved by employing banks or brokers to act as intermediaries between the public and the Treasury.

Much more momentous than the question of hiring a broker to place a government loan are such problems as these: what rate of interest shall be offered; shall the securities issued be sold at par, below par, or above; shall the securities be uniform in tenor or is variety desirable; shall the repayment of the principal be guaran-

teed at all, and if so, when; and lastly, is it advisable to tax such public securities or the income which springs from them ?

So far as the rate of interest is concerned, it must be remembered that the government has not the power arbitrarily to determine the rate which it will pay upon the capital it borrows, and this for the simple reason that it takes two to make a bargain. The private capitalist will not lend unless he gets what seems to him fair remuneration. Public credit, like private credit, is gauged by the money-market, and the finance minister must pay the price asked, or go without the accommodation he desires. He may perhaps conceal the real rate of interest he pays by fixing a nominal rate of interest upon the securities to be marketed, and then selling them below par. But he cannot simply dictate the rate of interest. The solvency of the government cannot be materially altered by his fiat. He does his duty when he intelligently ascertains the market estimate of the public credit, and this he may learn by making explicit the terms of the proposed loan, and inviting competitive bids from would-be purchasers of the public securities.

Several considerations emerge when the question is mooted of selling bonds at par or below. There is, first of all, a sentimental consideration which always weighs somewhat in the matter, to wit, the official and also the public pride in seeing the public debt sell at par or, if possible, above. But it may happen that the nominal rate of interest offered is so low that the loan must be contracted below par or not at all. Or it may chance that the rate of interest which would have to be guaranteed to market the securities at par would exceed the rate commonly allowed by law, and would be usurious if exacted on a private loan. Of still greater moment is

the fact that on public securities sold below par a lower rate of interest will be accepted by the public creditor than that which he would demand if the loan were placed at par or above. If, for example, a bond bearing five per cent. interest could be sold at par, it is not improbable that a four per cent. loan would bring, not eighty cents on the dollar of scrip, but eighty-five cents or thereabouts. The reason is this. In order to redeem a bond sold at par the state must return a dollar for each dollar originally received. Where the bond has been sold below par, say at 85, the state must pay a dollar for each eighty-five cents originally received. In other words, a bond sold below par offers two chances of gain, the annual interest and a bonus at redemption, the bonus being the difference between the actual price paid and the nominal face value of the bond. Should the state be in a position to redeem a part of its debt, or to compel its creditors to accept a low-interest bond for a high-interest bond, it will be more likely to redeem or convert the debt which was sold at par or above. Thus a longer duration will ordinarily attach to the bond sold below par. For these reasons, where the need for the greatest possible yield from the sale of public securities outweighs the estimated utility of future reductions in interest, or redemption of debt, financiers have sold government obligations below par. Obviously, there can be laid down no rule, in the placing of bonds at par or below, except this, that where the policy of ultimate debt payment is in vogue, the realization of such an end must not be sacrificed to an inconsiderable present gain. For the policy but recently (1898) adopted by the United States of selling bonds at par to small purchasers of public securities, when other larger bidders would offer a premium, there can be no financial justification. Political reasons, such

as making the loan ostensibly a "popular loan," may dictate such a course, but sound finance never.

This weighing of present against future must also determine to a very large extent the related question of uniformity or variety in the public debt. If administrative convenience alone were consulted, the former would prevail. If the whims of bond buyers were catered to, we should emit public securities in endless variety. It is probable that the latter plan, like that of placing bonds below par, would net the Treasury the greater amount in immediate cash. If rates of interest, periods of payment, and duration of loans were all adjusted to the tastes of purchasers, they would be willing to pay a trifle extra for this accommodation. Here again practical exigencies must determine. It is hardly probable, however, that the immediate need of money will be so imperative as to necessitate an endless variety in public securities. Indeed there are some advantages in having at most a very few varieties. Small blocks of stock, each cumbered by its own peculiar characteristics or eccentricities, are less readily listed and less generally understood than a few standard varieties judiciously chosen. Indeed the time has almost passed when governments are under the necessity of catering to public creditors by offering them such adventitious inducements as were in vogue formerly when lotteries and prizes of all descriptions were attached to public loans in order to invite general investment in government securities.

Whether the bond owner should be taxed upon his bonds and their income is again a question largely to be decided upon the present need of capital as compared with the future need of revenue. Guaranteeing the bonds against future taxation undoubtedly gives them a higher value on the market than if their ownership car-

ried with it the liability of tax contribution. Here, however, administrative reasons seem to favor the exemption of public securities from taxation. So far as the public debt is registered upon the books of the Treasury, the taxation of such debt is simplicity itself. The tax may even be deducted before the interest on the debt is remitted to the owner of the bond. But where the government debt is not registered, but exists in the coupon form, the collection of taxes imposed thereupon, unless by means of a stamp tax, would not be so easy. The important thing is that the question of the bond-holder's liability to taxation be definitely settled when the bonds are sold, and that the government strictly adhere to the bargain it makes. Taxation of a bond sold as exempt from taxation amounts to partial confiscation of the bond-holder's property.

(*c*) *Conversion of Public Debts.*—Not infrequently it happens that when the necessity which required the government to borrow is a thing of the past, the government can obtain money at a lower rate of interest than it had to pay in its hour of need. If, therefore, the government has the right to repay the principal of its debt or any part thereof, it will naturally avail itself of the opportunity in order to lessen the annual interest charge which is paid out of current taxation. Often this process of conversion or refunding takes the form of offering new securities bearing the new (and lower) rate of interest, and using the proceeds of the new loan to pay off the holders of the old loan. This refunding operation, as it is termed, sometimes is simplified by allowing the holders of the old bonds to exchange the old bonds for the new at some rate of exchange mutually agreed upon by the Treasury and the public creditor. Where the public debt is largely in the shape of perpetual debt, conversion

is sometimes effected by inducing the holder of a perpetual annuity to exchange it for a terminable annuity. The terminable annuity gives the annuitant a larger annual income, but at the end of a specified period lapses altogether. A similar process is employed to convert long time annuities into short time annuities.[1] As remarked above, bonds sold at or near par offer fewer obstacles to conversion than those sold below par.

(*d*) *The Extinction of Public Debts.*—In explaining the process of converting perpetual annuities into terminable annuities we have come upon one method by which public debts are sometimes expunged. The question of the policy of paying off public debts remains for our consideration.

It seems highly probable that much of the feeling in favor of the ultimate redemption of the public debt will be found to rest upon what is really an illegitimate analogy between public and private indebtedness. A judicious horror of debt is doubtless a very commendable sentiment for a thrifty individual to cherish. But to conclude without further reflection that a public debt affects a nation in precisely the same way as private debt affects an individual would be altogether premature. In saying this we would not countenance for a minute the fallacious idea that, except where interest is paid to foreigners, the income received by bond-holders is only a transfer from one set of citizens to another set, 'from the right hand to the left,' and can never imply a national sacrifice. The same argument would apply to justify what one citizen stole from another. On the other hand, the sentiment formerly expressed in the United States in favor of perpetuating the public debt

[1] The term conversion is sometimes employed to designate the legally authorized exchange of evidences of funded debt for floating debts that have been duly audited.

in order to provide forever a bond security for the note-circulation of the national banks, or to afford all classes an opportunity to invest their savings, will be found equally fallacious. The real effect of a public debt, it cannot be too often repeated, is the exaction it makes upon the taxpayer for the benefit of the bond owner. Whether this sacrifice is excessive depends altogether, if we view the matter retrospectively, on what good the community realized or is realizing from the proceeds of the loan; and putting aside repudiation as unthinkable, the whole question of repaying the principal of a public debt must rest upon a comparison of the sacrifice to be entailed by heavier taxation in the present against the gain to be anticipated from lighter taxation in the future.

The arguments for and against the policy of debt payment are partly economic and partly political. We have already had occasion to review the economic argument that the repayment of the bond-holder will convert him into an active man of business. Indeed a very plausible argument might be made to show the industrial danger of just such a policy. If the bond-holders as a class are assumed to be retired gentlemen long unacquainted with actual business, a policy which would put into their hands a large amount of actual capital which they had personally to invest in productive enterprises, on pain of losing their incomes altogether, might result in the loss of that capital both to the capitalists and to the nation. Suppose, for example, that the bond-holders of a railway system were given in final satisfaction of their claims several branch lines in fee simple and were thenceforth under the necessity of operating the branch lines themselves. Is there reason to suppose that either they or the community would benefit by such a payment of the railway's bonded indebtedness? Where the proceeds of

a public loan have been invested in tangible material property yielding income in the shape of actual money revenue, or in the form of general utility, and where either out of the earnings of the first or out of the appreciating value of the second all danger or expense on the score of depreciation, replacement, repairs, and the like is removed, there is no sound economic reason which inevitably dictates the repayment of the principal of the debt, any more than there is a reason why the tenant of a rented house, if the rent be moderate and the house commodious, should inevitably purchase the house outright. The economic argument for the repayment of the principal of public debts applies, however, to most cases of local indebtedness where the loan has been embodied in public property of some kind, such as sewers, streets, parks, and public buildings, where the public property in question is subject to depreciation, wear and tear, and will require ultimate replacement. To neglect in such cases to repay the principal of the debt would be to confront a situation in future where the utility of the property had vanished, and the debt charge had become a burden holding the community in mortmain. Here unquestionably the economic life of the property as estimated by competent engineers must determine the period at the end of which the debt incurred for such property ought to have been extinguished.[1]

[1] Dietzel (System der Staatsanleihen) has developed an ingenious but dangerous theory which minimizes the necessity of repaying the principal of certain public debts where, though there remain no tangible public assets, there is assumed to exist a certain amount of "immaterial capital" capable of giving off income sufficient to meet the permanent interest charge. If, for example, the state should sell bonds to equip a system of industrial schools, the trained ability of the pupils would constitute in his view "immaterial capital" sufficient to pay the interest on the loan even after the school buildings had become useless. Such "immaterial capital" is not measurable,

The chief reason for the redemption of debts created by our state and local governments, then, is an economic reason, and the rapidity of such repayment can be gauged generally on concrete grounds. On the other hand, the great reason for the expungement of national obligations is political rather than economic. Nothing is of such essential assistance to a nation in war time as unimpaired credit, and nothing impairs the national credit so much as a heavy and permanent debt charge. If the adage, "In time of peace prepare for war," be sound, the payment of a national debt with as great rapidity as is compatible with reasonable commercial and industrial prosperity is sound policy. The rate at which repayment is made must depend on the extent to which it is wise to extend taxation beyond the current ordinary expenses of the government. Taxes that especially hamper industry may be taken off in the hope that the freeing of enterprise will be felt in a heavier yield of the taxes still left in force. Still it is conceivable that the national debt payment may be carried on with too great rapidity. The disinclination nations show to carry war-taxes after peace has been concluded shows that they prefer present relief to a future exemption from meeting debt charges. Nor is there any special utility in national finance of setting aside a fixed amount or sinking fund, each year, irrespective of current income and current expenses. The only effective sinking fund for purposes of our federal government is such due economy in time of peace that a clear surplus shall be left over from year to year which may be applied to the extinction of a part of the public debt, either through the ordinary methods of redemption

and such public property, though it involve what is extraordinary expense for a year, involves what is ordinary expense, if we take a generation for our time period. It ought therefore to be paid for within the generation.

of the debt at maturity, or by purchasing it before maturity in the open market. On the other hand, local debts ought to be repaid within a calculable period. The expenses of the smaller units of government are not likely to be suddenly increased by unforeseen exigencies such as war. A sinking fund provision which requires a certain amount to be raised yearly and applied to the redemption of the local debt is a safe and commendable financial device.

CHAPTER II.

RELATION OF THE FEDERAL TREASURY TO OUR MONETARY SYSTEM.

Administrative Detail.—Outlined in the preceding chapter stands a brief description of the abstract process of borrowing on the public credit which financiers commonly avail themselves of in order to meet a current deficit. To complete the subject of Treasury Management a synopsis of the actual processes of fiscal administration ought perhaps to be added. That is to say, some account of the typical kinds of work performed by the various departments of the ordinary state or city treasury would naturally be next in order. We should have to eliminate, of course, a thousand and one peculiarities of detail which have become engrafted on the fiscal régimes of the different commonwealths. But allowing for these differences, we should find very general employment of some system of anticipating the yield of taxes by a sale of speedily maturing bonds whose proceeds become immediately available for public needs, and whose repayment is made out of the taxes as they are finally paid in. We should find numerous examples of a curious and rather cumbrous system[1] of public book-keeping where the public moneys, instead of being lumped together in one general balance,

[1] See Seligman, Finance Statistics of American Commonwealths; also E. L. Bogart, *Die Finanzverhältnisse der Einzelstaaten der nordamerikanischen Union.*

are apportioned and credited to numerous "funds," as they are termed, each fund appropriated to some specific object, such as education, and each having not infrequently a sort of lien upon a given fraction of the commonwealth's receipts. We should be under the necessity of recounting the various steps by which the revenues are covered into the treasury, of the methods by which such revenues are safeguarded, and disbursed only in accordance with law by means of warrants drawn by the proper official upon the custodian of the public moneys. The whole process of securing vouchers for the sums so paid out, and the details of accounting and audit, both by the administrative departments and also by investigating committees of the legislature, would have to be rehearsed. There are naturally countless minor differences in the fiscal administration of the commonwealths, ranging all the way from no system to the excessive red tape of a veritable Circumlocution Office. But a delineation of such administrative processes would be aside from our present purpose. Nor would the most general account suffice equally for the federal and the state treasury departments.[1]

It is not merely because of the greater size and importance of the former that there is need of a special study of the federal Treasury, but because that bureau, in addition to its ordinary fiscal functions, has been charged with doing an immense banking business. There is no more natural or necessary connection between collecting public money and banking than between running a grocery store and banking. But

[1] A full description of the various departments of the Treasury and their duties may be found in Senate Report 507, Part 3, 50th Congress, 1st session (1888). See also the Political Science Quarterly for 1891 and 1892.—The Control of National Expenditures, by E. I. Renick and N. H. Thompson.

Congress in its wisdom has joined together these things which the ordinary laws of trade would have put asunder, and the infelicities of the ill-assorted match demand attention.

Every other public treasury in the United States receives the currency it finds in circulation and pays it out again, and has no further concern with the circulating medium. The Treasury of the United States, on the other hand, is concerned not only with the collection and disbursement of money, but much of this very money which it collects and pays out is the child and creature of the Treasury itself. Naturally, complications must arise under a system where the Treasury in the capacity of national publican at the receipt of custom receives back again its own promissory notes, and where the Treasury as public paymaster issues these same notes to its creditors, and undertakes at all times to redeem them on demand in coin.

The Status of the Treasury.—The haphazard character of our American method of administration is well illustrated in the present constitution and work of the Treasury Department. The tendency we betray of delegating to a governmental bureau additional duties as need arises from time to time is exemplified in the curious farrago of minor interests with which, in despite of any appearance of logical allotment, the Treasury is now charged. Apart from the more or less divergent claims of banking and tax collection, the Treasury is obliged to look after the steamboat inspection service, the lighthouse service, the life-saving service, the marine hospital service, and the national quarantine. There seems to be no end to the accretion of adventitious duties growing out of the Treasury's use of the revenue marine to collect the customs. Thus Oregon salmon and Alaskan seals figure

among the latest protégés of that ubiquitous department.

The history of the development of the Treasury makes a curious story. It illustrates the early triumph of the advocates of an entire divorce between bank and state. It exemplifies as well the gradual disintegration of this once accepted principle, and the well-nigh universal dominance of the exact opposite—the union of bank and state.[1] The people of the United States, through Congress, chartered the first bank of the United States early in Washington's administration. The federal government itself was a large stockholder in the bank, which kept the public moneys on deposit and furnished a uniform and acceptable paper currency for twenty years. Then the Bank's charter expired, and the attempt to extend it proved unavailing. After the war of 1812 Congress was again induced to charter for twenty years the second Bank of the United States, and again the federal government became a large stockholder in the Bank and appointed a part of the board of directors. As before, the Bank acted as the financial agent and depository of the national government, and furnished the commonly employed paper currency of the land. It would take us too far out of our narrow course to go into the details of the "Bank War" which was waged against the Bank with unrelenting virulence by Andrew Jackson while President, and which resulted in the complete discomfiture of the Bank and its final extinction. The business of supplying a paper currency thereafter was taken up with avidity by the banks chartered by the various states. The federal Treasury for a while availed it-

[1] See David Kinley, The Independent Treasury of the United States; also A. C. Gordon, Congressional Currency; also the articles on the Independent Treasury in Lalor's Encyclopedia.

self of some of these state banks—"pet banks," as they were termed in the political slang of the day—and deposited funds therein. The crisis of 1837 proved that the Treasury had made a rueful bargain, and the loss of public money through bank failures and the suspension of specie payments brought the federal government into the lowest financial straits. Thereafter it was resolved that the government should be the custodian of its own funds, and after several abortive attempts the Independent Treasury was created by Act of Congress—a real entity, as opposed to the legal shadow it had previously been. The name—Independent Treasury—was itself meant to be a public renunciation of any future union of bank and state. The Act of August 6, 1846, provided quarters for the Independent Treasury, prohibited it from depositing any of its funds with the state banks, and forbade it to accept in payment of taxes or otherwise, the circulating notes issued by the state banks. The Treasury could receive and disburse only coin or its own obligations, and the divorce of bank and state was seemingly made complete and effectual. This policy of isolation lasted until the Civil War. Since that time the history of the Treasury is the story of successive reversions to a radically different type of fiscal organism. Between 1846 and 1861 the Treasury pursued with success its plan of keeping its own funds, of receiving specie and of paying it out again. Its transactions were on a comparatively modest scale, for extravagant expenditures were then neither necessary nor popular, and no untoward effect was produced upon the general monetary circulation by the relatively insignificant amount of coin the Treasury at one time held or at another time disbursed. The Treasury was reproached by its critics for refusing to recognize the system of

bank credit which the people availed themselves of in their ordinary commercial transactions. But the "hard money" policy of the Treasury was amply justified on more than one occasion. In the crisis of 1857 the Treasury experienced no embarrassment whatever, in marked contrast to the agonized struggles of the banks, and in contrast to the plight of the Treasury itself twenty years before, when the funds had been placed in the keeping of the state banks. Moreover, while the rigid requirement of payments in specie occasioned what many chose to represent as unnecessary hardship in the light of the developed state of credit transactions, still the Treasury's insistence upon a coin basis was of inestimable advantage in an era when people were not only willing to use credit, but altogether too prone to abuse it. The Treasury more than once stood forth as a beacon of light in the darkness when the country was in the throes of financial disaster. It is true that there were issued from the Treasury during the period 1846–61 its own promissory notes which circulated to some extent as currency, and were receivable for taxes. But the amount of these notes was never great. They were never made by law a legal tender in payment of private debts, and their volume never necessitated any special specie reserve to provide for their redemption.

All this was speedily changed, beginning in 1861. The necessity for speedily obtaining capital induced Secretary Chase first to break down the barriers that had been erected between the Treasury and the banks by approaching the banks to obtain loans from them on several occasions. Next, the cautious traditional policy of strictly limiting the amount of circulating notes issued by the Treasury was flung aside, and issue after issue of promissory notes was made at Secretary

Chase's suggestion and with the approval of Congress. These notes were clothed with the prerogative of being a legal tender, and were forced into circulation. Finally, in 1863 and 1864, the National Bank system was instituted; and, the better to afford a market for United States bonds, the national banks were allowed to issue upon the deposit of such United States bonds as they had purchased, a national currency, acceptable by the Treasury except for certain specified dues, and to be used by the Treasury along with its own obligations in ordinary payments to its creditors. The Treasury undertook, moreover, to serve as the central redemption agency for the national banks, and Congress finally drove into the national banking system most of the still recalcitrant state banks by imposing a prohibitory tax upon their circulating notes. Finally, the last landmark which hemmed off the Treasury from the banks was swept away when the national banks were made by law authorized depositories for the public moneys. Within twenty years after the legal creation of the Independent Treasury, the Treasury was independent in name only; and the absolute divorce between bank and state which Jackson and his party had striven for and attained was set aside, and the closest union between these two financial organs has existed ever since.

Of all the executive departments of the general government the Treasury is most complex and inclusive. Besides the central treasury office at Washington, there are nine sub-treasuries in as many large cities, several mints, assay-offices, and numerous other offices and agencies, including a varying number of National Bank depositories, scattered throughout the land. The head of the bureau, the Secretary of the Treasury, is a cabinet minister and an adviser of the President. Under the

Secretary stand the Treasurer, the Assistant Treasurers, the Comptroller of the Currency (the head of the National Bank system), the Register of the Treasury, the Director of the Mint, three Assistant Secretaries, and a host of under-officials, clerks, and employés in the various ramifications of the several sub-departments of the Treasury system. Of all the executive departments the Treasury and the Post-office most frequently and extensively come in contact with the people and affect them for good or for evil.

Fiscal Functions of the Treasury.—Had the Treasury permanently conformed to the design of the founders of the Independent Treasury, there would be little to say about its fiscal operations—of its collecting and spending the public money—which would not be equally true of the treasuries of the various commonwealths. In magnitude of operations alone the federal treasury might be found to differ from the analogous fiscal engines in the states. It would, of course, be necessary to point out that the federal revenue is derived from sources different from the revenue sources of the states and smaller civil divisions. The federal government, moreover, has been charged from the beginning with the duty of striking coins, and to-day at its mints converts without charge into standard coin all gold deposited for the purpose by its citizens. This is a duty which the treasury departments of the states are absolved from. Theirs is the simpler task to collect, safeguard, disburse, and account for their revenues. So long as we do not trench upon administrative detail we may say as much, or rather as little, of the United States Treasury. Into its charge fall the federal taxes from customs and the internal revenue, and from postal and miscellaneous receipts. The proceeds of bond sales are also in the first instance

covered into the Treasury. The distribution of its cash assets among the sub-treasuries, as well as the placement of its funds in designated depositories, requires careful attention and sound judgment. The same may be said of protecting against loss the cash assets in the Treasury, and rigidly accounting for all funds from the time of their receipt to the day of their disbursement. In one way alone is the Treasury in the performance of its strictly fiscal duties liable to create serious difficulty—a difficulty, moreover, which can hardly arise from the operation of other public treasuries in the United States. We refer to the contraction of the currency by Treasury absorptions in excess of disbursements. The receipts of the Treasury are regular, and, excepting the proceeds of bond sales, do not vary greatly from day to day, or from week to week. Its disbursements, on the other hand, are largely periodic. Thus the interest on the public debt is paid normally at quarterly intervals. Pension payments figure largely in the Treasury payments for one month, and may not recur the month following. If these payments were relatively inconsiderable, the contraction and expansion of the currency which they now occasion would be scarcely felt. But they are not inconsiderable, and when the currency is steadily contracted by growing Treasury holdings, and then of a sudden the accumulation of cash is poured out into the bank reserves of New York and other large cities, the disturbance in the money-market is often keenly felt. Exchanges are hampered, and current rates of discount are increased, by the stringency which the Treasury's absorptions unwittingly cause. This is especially likely to occur in the case of a bond sale, when the Treasury within a short period of time absorbs a vast amount of currency paid over to it by the pur-

chasers of the bonds. Here it is the irregularity in receipts rather than in payments which creates trouble, unless the previous plethora of currency is such that what the Treasury takes simply relieves the congestion. These arbitrary variations in the amount of money in circulation are bound to arise whenever the government's income and outgo (provided they are relatively large enough to affect appreciably the total circulation) do not approximately go hand in hand. The difficulty may be largely abated by timing disbursements, even by anticipating certain payments before they fall due, in order to prevent any undue disturbance of the money-market. In the case of bond sales, much of the money received by the Treasury may be immediately redeposited with the national bank depositories, provided always that they can furnish the bond security necessary for receiving federal money on deposit. The actual cash in this way will not leave the bank vaults nor be subtracted from the banking reserve, and the credit created in favor of the Treasury will be successively drawn upon until it is quite expunged. When Treasury disbursements exceed its receipts, the effect is to lessen the Treasury's cash and to force back into the channels of general circulation not only every dollar taken in by way of taxes, but the additional sums paid out of the Treasury's original cash balance. In this case the congestion of the money-market is made worse, and can be relieved normally only by the export of coin, or by the sale of bonds for cash.

The Banking Operations of the Treasury.—When it is said that the Treasury in addition to gathering the federal revenues and paying them out undertakes the business of banking also, the statement must be guarded to prevent possible misapprehension. The cardinal du-

ties expected of a banker are to lend or advance upon business paper or securities, to engage to pay upon the order of depositors, and to furnish a paper currency for the use of the community. These are the well-known functions of discount, deposit, and issue.[1] It is only the last function which the Treasury undertakes on a great scale.

(*a*) *Certificates of Deposit.*—It is true that the Treasury issues certain certificates of deposit which circulate as currency, amounting to five hundred million dollars, or more, in the aggregate, but these certificates are analogous to warehouse receipts rather than to ordinary bank deposits. The holders of standard silver dollars may deposit them in the Treasury, and receive in lieu thereof notes certifying that such or such a number of silver dollars have been deposited, and are to be had at any time upon presentation of and in redemption of the certificates. The holder of the certificate is the owner of the coins which are held at the government's expense in the Treasury vaults.[2] In like manner the holder of gold coin may deposit it in the Treasury,[3] and receive similar certificates of deposit analogous to those just described. Both the gold certificates and silver certificates bear no interest and pass like ordinary currency from hand to hand. But such deposits are manifestly very different from ordinary bank deposits, where the bank obligates itself to pay certain sums to the order of its depositors, and holds to meet these liabilities a cash reserve amounting to but a frac-

[1] See C. F. Dunbar, The Theory and History of Banking.

[2] The outstanding amount of silver certificates (Feb. 25, 1899) is $401,589,504.

[3] Except when the gold reserve falls below $100,000,000. The outstanding amount of gold certificates (Feb. 25, 1899) is $34,609,729. Neither the gold certificates nor the silver certificates are a legal tender, although the coin they command is a legal tender.

tion of its total liabilities. The Treasury, on the other hand, holds the coins deposited as an inviolable reserve available only for redeeming the certificates issued. The Treasury, therefore, is asked to issue these certificates of deposit rather because it acts as a monetary warehouse which makes no charge for storage than because it is engaged in deposit banking. Indeed it would be more correct to say that the Treasury gratuitously maintains a safety deposit warehouse for standard coins than to affirm that the Treasury undertakes the business of deposit banking proper. Through the national bank depositories the Treasury provides credit balances against which the federal disbursing officers draw; and it engages, as the redemption agency of the national banks, to redeem in the first instance national bank notes presented for redemption, but these tasks are relatively unimportant in scope, and cannot be said to alter essentially the contention that the deposit operations of the Treasury are mainly because of the Treasury's possession of a strong vault and not because of the Treasury's undertaking the risks of ordinary deposit banking.

(*b*) *The Issue and Redemption of Circulating Notes.*— The real magnitude of the Treasury's banking operations will first appear when we regard the vast amount of demand notes it issues bearing no interest. These notes circulate as currency, and for their redemption the Treasury exerts itself to provide the requisite amount of gold coin. The exact nature of this part of the Treasury's work can be understood only by examining closely into the character of the notes in question.

First in order comes the "greenback,"—or the United States note, as the federal statutes more decorously term it. Historically, these notes originated in the pressing needs of the government during the Civil War. Not

having the coin to pay for the supplies it required, the government issued its promises to pay coin, and endowed these promises with the quality of serving as a legal tender in payment of debt. They went readily into circulation, though their purchasing power was much less than that of the coin the government pledged to pay to the bearer of the note. When the notes were first issued, and indeed for many years thereafter, the Treasury made no pretence of redeeming the notes in coin. The value of the greenbacks therefore constantly fluctuated, depending on the estimate the market put upon the nearness or remoteness of their equivalence to coin. This in turn was seen to depend upon the number of greenbacks in circulation, the success of the federal arms, and various other circumstances. Originally, therefore, the greenbacks came into being as the I O U's of an impecunious debtor. They circulated the more readily because the government took away the protection of law from creditors who refused to accept in satisfaction of private debts owing them, the tender of the government's discredited promises. The total amount authorized was in excess of four hundred million dollars, and practically this amount was outstanding when peace ensued, and the government faced the disagreeable necessity of paying its debts. The design of the originators of the greenback currency was to provide only a temporary expedient for staving off the day of actual payment. The notes were not intended to constitute a permanent currency, and, very shortly after the establishment of peace, Congress, in one of its occasional spasms of rhetorical virtue, declared for the early retirement of the greenbacks and their speedy redemption in coin. The Treasury actually began to cancel and destroy certain greenbacks paid in on account of taxes.

But no sooner had the process begun than the shoe began to pinch. The withdrawal of a part of the currency through this destruction of greenbacks produced a feeling of stringency in the money-market. The Treasury, in consequence was prohibited from pursuing the policy of destroying these evidences of the government's indebtedness, and at a subsequent period [1] even threw back needlessly into circulation many millions of the greenbacks that stood uncancelled in the Treasury vaults. The currency that we had at first endured as a military necessity we began to embrace as permanent currency; and these evidences of national insolvency were invested with the halo of patriotism, as the "blood-stained greenbacks" became the battle-cry of those whose interests led them to deprecate the contraction of the currency and to oppose an immediate return to specie payments. The Resumption Act, which was finally passed January 14, 1875, authorized the Secretary of the Treasury to sell bonds in order to accumulate coin "to prepare and provide for the redemption" of the greenbacks. This policy of redemption in gold coin upon the holder's demand was successfully inaugurated January 1, 1879, and ever since has been continued. But most curiously, and as if to illustrate the tenacity of an inconvertible currency's power for evil, Congress by Act of May 31, 1878, prohibited the Treasury thereafter from cancelling or destroying [2] any of the then outstanding greenbacks, even though redeemed in gold, and required that such notes as were paid into or redeemed by the Treasury

[1] For the history of these transactions consult Noyes, Thirty Years of American Finance; Bolles, The Financial History of the United States, Vol. III.

[2] Worn or torn notes may be cancelled and destroyed, but must be replaced by new notes to the same amount. The exact greenback circulation is $346,681,016.

should be reissued. The amount of greenbacks existing at the time of the passage of this act was about $346,000,000, and has remained at that figure ever since. Here, then, is the first part of the Treasury's gigantic task as a bank of issue, to keep in existence at all times and under all circumstances its promissory notes to an amount of $346,000,000, and to redeem any or all of such notes in coin (practically gold coin) at the demand of the note holder. The expedients for obtaining the coin required for redemption purposes may be discussed more advantageously after we have described the next class of Treasury obligations.

As though the responsibilities resting upon the Treasury were not already heavy enough, Congress by Act of July 14, 1890, required the Treasury to purchase 4,500,000 ounces of silver monthly, and for the bullion so purchased to turn over to the sellers of silver bullion what were termed Treasury Notes or Coin Notes. The measure in question was a compromise between the advocates and opponents of a more extended use of silver money, and the law was commonly known as the Sherman Law, inasmuch as Senator Sherman was the chairman of the Senate committee which evolved the measure.[1] These monthly purchases of silver bullion continued until the fall of 1893, when the purchase clause of the act was repealed (November 1, 1893). The notes which the Treasury issued to acquire the bullion purport to be redeemable upon demand in "coin," and the law ostensibly confers upon the Secretary of the Treasury the option of redeeming the notes in gold or silver coin as he may elect. The notes are also made a legal tender in payment of debt. If re-

[1] The notes issued by virtue of the act are often termed Sherman notes as well as Coin or Treasury notes.

deemed in gold, they must be reissued. If redeemed in silver, they must be cancelled.[1] In practice the option conferred upon the Secretary of the Treasury to redeem them in either gold or silver has proved nugatory. Their holders ordinarily ask for gold, and the Treasury accedes, fearful that a refusal would destroy the equal purchasing power of gold and silver currency. Substantially, then, the Sherman law has compelled the Treasury to assume an enormous liability for about a hundred million dollars additional in the shape of circulating demand notes, redeemable *de facto* in gold, and only slightly contractile in volume.

Notwithstanding the different historical origin of the greenback and the Treasury note, and certain unessential variations in their legal attributes, they are best regarded for many purposes as a practically homogeneous block of government obligations, amounting in all to nearly five hundred millions of dollars. Both are promissory notes of the government. Both circulate as currency. Both are a legal tender. Both are redeemable on demand, and practically in gold coin. When so redeemed neither can be retired, but both must be reissued. To all intents and purposes the greenbacks and the Treasury notes constitute a practically irreducible quantum of government obligations payable on demand in gold. We must next inquire into the methods by which the Treasury obtains the gold for redeeming the legal tender notes.[2]

[1] The silver coin with which they are redeemed may be deposited in the Treasury, and silver certificates obtained in exchange. In this way some millions of Treasury notes have been transformed circuitously into silver certificates. But generally the Coin notes are redeemed in gold and reissued. The amount of Coin notes Feb. 25, 1899, was $95,577,780.

[2] Legal tender notes is a convenient caption for designating both the greenbacks and the Coin notes, as they alone of all our paper currency possess full legal tender attributes.

When the government in 1879 began again the redemption of its demand notes in specie, the stock of gold held for that purpose had been accumulated by the sale of bonds authorized in the Resumption Act of 1875. Secretary Sherman in 1878 obtained about $100,000,000 in gold coin with which to redeem on presentation any of the outstanding $346,000,000 of greenbacks. The Resumption Act did not designate any specific amount of gold to constitute "the gold reserve." The only statutory mention of what has become known as "the gold reserve" is found in an act passed in 1882 which forbade the issue of additional gold certificates[1] when the free or net gold in the Treasury should be below $100,000,000. The traditional gold reserve of $100,000,000, fixed upon by commercial consent as a sort of 'apprehension minimum,' and only incidentally mentioned by a later statute, had its origin, therefore, in custom pure and simple, and became a substantive entity merely by the long-continued practice of the Treasury to carry at least that amount of gold coin as a reserve held against the legal tender notes.[2]

The Resumption Act of 1875, which in many respects is entitled to be regarded as one of the pillars of our entire financial system, does not limit the amount of bonds which the Secretary of the Treasury may issue to obtain the coin necessary for redemption purposes, nor apparently does it limit the time during which the Secretary may exercise this power. Under the authority which the act confers, the Secretary of the Treasury on four occasions within the last few years has sold bonds to replenish his stock of gold coin. Besides building

[1] See p. 325.

[2] The gold coin in the United States amounts to about $825,000,000. Manifestly, the Treasury holds only a part of the whole.

up the gold reserve by the sale of bonds, the Treasury in normal times acquires gold through several less costly processes. Customs duties are by law payable in gold, and though it would be futile for the customs officials to refuse to accept legal tender notes in payment of customs duties (inasmuch as legal tender notes are convertible on demand into gold), a certain percentage of the customs receipts is normally paid in gold whenever the amount of circulating notes afloat is not so great as to flood the channels of exchange and displace gold in payments to the government. Moreover, on more than one occasion the Treasury has increased its gold holdings by offering to pay out at distant sub-treasuries paper currency, in exchange for gold voluntarily turned over to the Sub-Treasury in New York City. This has amounted practically to a voluntary exchange by the Treasury of its paper currency for the gold of private citizens. The latter have agreed to the exchange, because it saved them the trouble and expense of shipping currency to distant points to which they desired to make remittances. The Treasury, moreover, is generally willing to make a voluntary exchange of any of the paper currency or silver dollars in its own cash for equivalent amounts of gold coin.[1]

Before the total liabilities of the Treasury can be justly

[1] Besides the redemption of gold and silver certificates and of legal tender notes, the Treasury undertakes various other minor exchanges of certain kinds of currency for other kinds. Thus small change may be had in exchange for bills, and, conversely, bills may be had for small change. Torn, worn, or soiled notes are exchanged at the Treasury for new notes of the same denomination. Bankers often deposit legal tender notes in blocks of $5000 or multiples thereof and receive in exchange, currency certificates for equivalent amounts. The small notes so deposited in the Treasury are kept as a special deposit and are given back upon the surrender of the currency certificates. There is no law which compels the Treasury to give gold coin in exchange for silver dollars.

estimated, reference must be made to still another kind of paper currency, to wit, the circulating notes issued by the national banks. Before issuing their notes, the national banking associations are required to deposit in the Treasury, United States bonds as security to indemnify the note-holder should the bank fail. These bonds remain the property of the banks, which receive the interest thereon as it accrues. Upon the deposit of bonds, notes in blank are issued to the national banks amounting to ninety per cent. of the par value of the bonds deposited. These notes when countersigned by the president and cashier of the issuing bank, are paid out over the bank's counter and become a constituent element in our heterogeneous currency. They are redeemable "in lawful money" at the issuing bank, though it is safe to say that few, if any, national bank notes are thus presented for redemption. They are also redeemable at the Treasury at Washington, which serves as a central redemption agency for the notes in question. Each bank must keep on deposit with the Treasury five per cent. in lawful money of its note circulation. The banks may increase their note circulation by the deposit of additional bonds as security. They may reduce their circulation in whole or part by depositing with the Treasury an amount in lawful money equal to the outstanding note issue they desire to withdraw. The expansion and contraction of the national bank-note circulation is hampered by provisions limiting the aggregate amount that may be retired to $3,000,000 per month; also by provisions forbidding any bank reducing its circulation to increase its circulation again within a period of six months. The Treasury as a central redemption bureau manages, though somewhat slowly, to withdraw notes of banks reducing their circulation, and serves to

replace worn and soiled notes with fresh ones; but inasmuch as national bank-notes on the average are not presented for redemption in lawful money more than once in three years, their instant convertibility into coin at any and all times has never been very cogently demonstrated. The national bank-note circulation is in truth a rather torpid and immobile part of our composite currency. Its increase depends on a calculation of the possible profit to be obtained by the banks in lending additional amounts of their own notes. Such a possibility of profit by the national banks in a particular section of the country is no conclusive evidence that the country as a whole stands in any need of an increase in its circulating media. Similarly, national banks may retire their circulation, for instance, to obtain possession of the bonds deposited as note security, when an actual need of increased currency is felt. Certainly the responsiveness of the national bank circulation to variations in the need felt for currency is slow, and only evident when the need is widespread and unmistakable. The Treasury, then, in addition to the other manifold obligations resting upon it, stands as a sort of sponsor for the circulating notes of the national banks. Although unable to exert any direct control over their volume, the Treasury undertakes to redeem such notes; and although the banks are required to keep a five per cent. redemption fund with the Treasury for this purpose, and are required to make good all of their notes which the Treasury has first redeemed, the fact remains that the national bank circulation constitutes a huge bulk of obligations, all of which are redeemable in lawful money which, in turn, so far as it consists of legal tender notes, is ultimately a lien upon the Treasury's gold reserve.[1]

[1] The national bank-notes are not a legal tender, though

The liabilities of the Treasury on account of our paper currency can now be estimated with some degree of accuracy. First, come about $450,000,000 in legal tender notes, practically irreducible in volume, redeemable according to Treasury practice on demand in gold coin and resting wholly on the gold reserve. Next, come about $250,000,000 in national bank-notes whose volume, though not rigid, cannot be reduced by the Treasury, and which are capable of being used in a roundabout fashion so as to be a second claim upon the government's gold reserve. Lastly, come the gold and silver certificates amounting to $440,000,000 approximately, of which the first can occasion no trouble, as there stands behind it a reserve of dollar for dollar in gold.[1] But the silver certificates, though backed by an equal reserve in silver dollars, are likely to prove troublesome, inasmuch as the standard silver dollars have only about half of the bullion value of the gold dollar, so that but few of the silver certificates are presented for redemption in silver; and though there is no express statute compelling the Treasury to redeem silver certificates in gold, the Treasury has intimated its determination to do so, in case the refusal to redeem the silver certificates in gold would imperil the equivalence of the purchasing

they are received by the Treasury for all dues except customs, and are used by the Treasury in all payments except interest on the public debt. The amount outstanding Jan. 1, 1899, was $243,735,105, of which amount $214,016,088 are secured by bonds deposited, while the remainder is in process of extinction, the banks having withdrawn their bonds and substituted lawful currency to the amount of the notes. Such notes are not actually retired and cancelled until paid into the Treasury through the ordinary tax channels, though the bank's obligations, so far as the notes go, cease with the deposit of lawful money in the Treasury.

[1] The gold reserved to cash gold certificates is not a part of the gold reserve. It amounted (Feb. 25, 1899) to $34,609,729. The silver certificates amounted (Feb. 25, 1899) to $401,589,504.

or debt-paying power of gold and silver dollars.[1] The silver dollars upon which the silver certificates were issued, stand therefore as a sort of unavailable banking asset, whose chief influence is to prevent the silver certificate in any case from dropping in value below the bullion value of the coin on which it was originally based. In the last analysis, then, the matter comes to this: there are outstanding demand notes amounting to over a thousand million dollars which the Treasury in practice holds itself ready directly or mediately to redeem on demand in gold. The gold available for this purpose can readily be obtained in times of industrial activity and brisk monetary circulation from customs receipts and through exchanges made by individuals who voluntarily part with their gold for various kinds of paper currency. But this easy and economical maintenance of the gold reserve ceases whenever the Treasury for any considerable period and to any considerable extent pays out more money than it concurrently takes in. The Treasury's gold reserve in this case is poured out to meet current expenses, and is reduced accordingly. If the channels of circulation are filled with paper currency, the gold receipts from customs dwindle or disappear. Instead of individuals seeking voluntarily to exchange their gold for paper currency, legal tender notes are presented for redemption in gold, either because the gold is wanted for export to pay foreign creditors, or because the continued solvency of the Treasury is questioned, and gold, in consequence, is hoarded. In

[1] "Even further than this, it [(i.e., the Treasury)] has declared itself ready, whenever necessary to the maintenance of this parity, to exchange on even terms, at the pleasure of the holder, either form of the metallic money for the other."—*Report of the Secretary of the Treasury, 1897*, p. lxxii.

this exigency there is no alternative but to issue bonds to obtain additional gold.

The peculiar feature of the constitution of the Treasury does not consist merely in the vast bulk of demand obligations it continuously floats, nor in the Treasury's inability to lessen materially the bulk of these obligations, even when they are once redeemed, nor yet in the precarious and clumsy method of obtaining gold for redemption purposes in time of stress;[1] but the singular the unique, part of the Treasury's task is the requirement laid upon it of conducting at the same time an enormous fiscal bureau and an enormous bank of issue, and *using the assets of the two concerns as interchangeable.* Gold received in customs payment is frequently used to redeem legal tender notes. Gold received from bond sales (made ostensibly for acquiring gold to redeem legal tenders) is used for paying current expenses. Thus a deficit in ordinary revenue, if considerable, may deplete the gold reserve and necessitate an increase in the funded debt; while surplus revenues, by temporarily locking up money in the Treasury, increase the percentage of the Treasury's gold receipts, and automatically enlarge the gold holdings available for its banking reserve.

A deficit in revenue undermines the banking reserve, shakes confidence in the Treasury's solvency, and necessitates an increase in future taxation to meet the interest on the increased funded debt. An ample banking reserve, on the other hand, can, under present circumstances, be assured only by a wasteful system of taxation that takes out of the pockets of the people more than the needs of the government require. Such a surplus of revenue, moreover, not infrequently produces a

[1] The bonds that may be issued under the Resumption Act of 1875 run for ten, fifteen, or thirty years.

dearth in the money-market just when booming trade stands in need of a plentiful currency to effect its exchanges.[1]

It would not lie within the scope of this work to sketch any project for reconstituting the Treasury and the national banking system. Most unbiassed critics admit the necessity of separating the fiscal from the banking operations of the Treasury. This at least would let us know approximately the cost of each,—a fact now hopelessly beclouded. It would also prevent political tyros from ascribing all our financial ills either to a revenue deficit exclusively or to note redemption exclusively. This in itself would be no small gain. Beyond this separation of the two generic operations of the Treasury, some method of reducing the Treasury's demand obligations, either by funding some of the existing demand notes, or by converting them into what practically would be gold certificates, seems highly advisable. The latter plan would provide that greenbacks, for instance, once redeemed in gold, should be corralled in the Treasury, and thereafter issued only in exchange for an equal deposit of gold coin, the coin to be held as an inviolable deposit for the future redemption of these notes. To prevent a contraction of the currency from arising

[1] Incidental to the Treasury's position as a great bank of issue are the special functions it is expected to perform in times of monetary stringency. Clamor arises for unusual disbursements, for anticipating interest payments on the public debt, or for the purchase of the debt outright in the open market in order to relieve the stress. Even in ordinary times when government receipts are unusually large, as in July 1898,—from recent bond sales,—the Treasury exerted itself to keep its accruing cash largely in national bank depositories lest a "currency famine" should prevail. Those who disbelieve in government banking find additional reason for their position in the inability of the Treasury to perform this additional work of keeping the money market properly provided with currency. When trade is slack and the Treasury pays out all it receives and even trenches on its gold reserve to make ordinary payments, the Treasury is reviled for "demoralizing" the money market.

through such reforms, and to introduce greater elasticity into the note circulation, various projects for allowing banks to issue notes in part, at least, unsecured by any specific deposit of bonds, and redeemable in practice as well as theory at the bank of issue, have been mooted.[1]

Concluding Remarks on the Monetary System.—The real character of our monetary system as it exists to-day is often, indeed usually, beclouded by dragging into its discussion some phase of the free silver issue or its more reputable but distant and possibly defunct relative, international bimetallism. If free silver coinage ever prevails, its advent will undoubtedly revolutionize the present system, but until that time arrives we may find it worth our while in the domain of finance to see things as they really are. Whatever we may think about what might, could, would, or should exist, the fundamental monetary fact of most far-reaching importance is that 23.2 grains of pure gold is the basis at the present time of all our commercial obligations. This is not meant, of course, to imply that a "gold clause"[2] is embodied in the usual business contract, but that, for one cause or another, all dollars are alike in having practically the same purchasing and debt-paying power. In other words, the most striking feature in our monetary system is the gold basis of commercial obligations and the parity of all dollars with each other. This fact, so universally patent, apparently so simple, and to industrial in-

[1] For a summary of such projects see article, The Objects and Methods of Currency Reform, by F. M. Taylor, Quarterly Journal of Economics, April 1898.

[2] When the continuance of gold payments by the Treasury was in doubt, commercial contracts frequently embodied a "gold clause" whereby the debtor bound himself not merely to pay "dollars," but specifically agreed to pay gold dollars of the standard weight and fineness.

terests so gratifying, we are apt to assume must rest upon some equally simple foundation. It will be found upon inquiry, however, to rest, not on a single substructure, but on several. These ought to be clearly distinguished in our apprehension of the matter, if we are to understand thoroughly all the conditions upon which the permanence of a universal gold basis of commercial obligations depends.

There are but two generic reasons why dollars of less intrinsic value than gold dollars obtain equal purchasing power with the latter. If the dollars of less intrinsic value are speedily convertible into gold on demand, dollar for dollar, their equivalence to gold in purchasing power is readily understood. It makes no difference whether or not there be gold enough to redeem the other dollars, if they were all presented at one time. So long as there is maintained sufficient gold for all exchanges likely to be asked for, the parity of the gold dollars and the other dollars will continue. But the parity of gold dollars and other dollars may be maintained in one set of circumstances even without concrete exchanges of the one for the other. If there be a general creditor of the dollar-using community who will receive gold dollars and other dollars as precisely equivalent in payments made to him, and if these payments be large in amount and regularly recurring from day to day, and if the amount outstanding of the less intrinsically valuable dollars be no greater than to necessitate their payment frequently to the general creditor, there is no mystery about the readiness of the community to regard all dollars as equivalent. The Treasury is such a general creditor. The payments due it are the hundreds of millions of taxes it regularly exacts. Its direct redemption in gold of legal tender notes, coupled with its ready acceptance

of silver currency (whose volume is virtually fixed[1]), and back of all, its pledge[2] to exchange one kind of currency for another if necessary, suffice to maintain the parity of all kinds of currency at the present time. So far, then, as the gold standard and the parity of all kinds of currency depend on legislation, it is manifest that they rest on the Resumption Act of 1875, which provides for bond sales when the necessity arises of obtaining additional gold to redeem the legal tender notes. But the gold standard and the parity of all kinds of currency rest not only on the positive provisions of this statute, but equally upon the absence of statutory enactments which would countenance a dangerous increase of the currency which either directly or indirectly would have to be maintained by the Treasury's gold reserve. In short, the power to issue and sell bonds granted by the Resumption Act is a clumsy but more or less effective way not only of providing the Treasury with the needed gold for actual redemption purposes, but of contracting temporarily the outstanding demand obligations of the Treasury. These demand liabilities, for a time at least, are held out of circulation, inasmuch as not all of the notes which have been redeemed are at once required for meeting immediate expenditures. Manifestly, the effectiveness of this expedient would be lessened and even destroyed if the Treasury's liabilities were increased indefinitely.

No less important than the Resumption Act itself is

[1] Silver is no longer purchased by the Treasury except in limited amounts for the coinage of fractional silver. Section 34 of the War Revenue Tax of 1898 directs that at least one and one-half millions of the uncoined bullion purchased under the Act of July 14, 1890, be coined monthly, and that "said dollars, when so coined, shall be used and applied in the manner and for the purposes named in said Act."

[2] See p. 336, note.

the administrative practice of the Treasury in construing "coin" to mean gold in case the government's creditor asks for gold. The point is well illustrated in the matter of the Coin notes. Here the Secretary of the Treasury is explicitly given the option of redeeming such notes in gold or silver. As a matter of fact, the holders of the Coin notes have obtained gold in exchange for them whenever they have demanded it. It is true that the Act of July 14, 1890, after providing that the Secretary of the Treasury shall "redeem such notes in gold and silver coin at his discretion," adds the phrase, "it being the established policy of the United States to maintain the two metals on a parity with each other upon the present legal ratio, or such ratio as may be provided by law." But it can hardly be asserted that the concluding clause would prevent a Secretary of the Treasury who was so disposed from redeeming Coin notes in silver. The clause quoted above which has so often been invoked as the warrant for redeeming Coin notes on demand in gold might easily be regarded as *brutum fulmen* by a Secretary who wanted to "do something for silver." That such redemptions in silver might destroy the parity of different kinds of currency is not unlikely. That such a result would be disastrous is highly probable. That the Treasury is to be commended for resigning its legal option in the matter is granted. But the point made is that the continued parity of all kinds of currency with each other may under certain circumstances be destroyed without color of illegality by a change in Treasury practice, without adding or altering a line in the statute-book.

The gold standard and the parity of all forms of currency are maintained by virtue of the Resumption Act and by an administrative practice of understanding

"coin" to mean gold coin rather than silver. If either the law or the practice were radically changed, our money system might be revolutionized. But there is still a third set of conditions which may be powerful enough to counteract both statute law and the canons of Treasury interpretation. These are those general industrial conditions which determine the general price level. Let the general price level in the United States rise markedly and steadily, and bring with it the necessity for more currency to transact exchanges, to such an extent that gold is imported from abroad, and the gold standard and the parity of all forms of currency would persist even though the Resumption Act were nonexistent and Coin notes were cashed only in silver dollars. Let the general price level fall, exchanges dwindle, and the currency become redundant, and both the exercise of the power conferred by the Resumption Act as well as the Treasury's promise of exchanging gold for any and all other kinds of currency will be necessary to maintain the gold basis of commercial obligations and the parity of all kinds of money. Our monetary system, therefore, in its essence—the single gold standard and the equal purchasing power of all our standard coins and our paper currency—depends on three sets of conditions, statutory, administrative, and commercial. These conditions may operate in the same or in opposite directions. The last, the most powerful of the three—the general price level—is least under governmental control. Its coming cannot be predicted, nor its permanence calculated, nor its capriciousness gauged. Foolish legislation may often hasten its departure, or retard its beneficent advent. But with wisdom the financial house may be put in order, whether the preparation prove the prelude to prosperity or the signal of the storm.

CHAPTER III.

BUDGETARY LEGISLATION.

The Budget.—Any description of a system of finance must stand incomplete, suspended as it were in the air, unless that description shows how finance is related to the political organism of which finance is after all but an offshoot. It is not enough merely to articulate the methods of raising and expending revenue, and to explain the effects of such administrative activity. We must venture into the theatre of legislation, where at present the financial drama begins, if we are to understand the often stereotyped rôles which the Treasury officials are compelled to play.

This province of financial legislation lies at the borderland of several contiguous fields of political science. Constitutional history, especially in modern times, handles no more important theme than the gradual growth of popular control over the public purse. The study of political activity in modern democracies centres largely in the array of opposing parties in matters of taxation. The science of administration touches no problem comparable to that of the economic regulation of the public household; and nowhere can comparative legislation be so advantageously studied as in the respective arrangements observed by modern senates in disposing of the budget, the most important item upon their legislative dockets. In this 'welter of competing

jurisdictions' the jurist, the historian, the administrator, and the student of politics are almost equally interested.

Financial legislation, if the scope of the term be not limited, suggests too broad a field of inquiry even for professedly financial treatises. In one sense of the term any law which entails governmental expenditure, as well as any measure which affects banking, the currency, the public debt, tax-administration, or any of a hundred other similar projects is a financial measure. But financial legislation *par excellence*, to wit, the yearly supplies accorded to the public service, or what is commonly dubbed budgetary legislation, is what most concerns us at this stage of our inquiry.

About the middle of the eighteenth century, when the Chancellor of the Exchequer rose to make his great annual financial speech in Parliament, he drew from his *bougette*, or bag, the various accounts which he laid before the assembly. From that time his speech was called, perhaps by way of nickname and in apprehension of the tiresome contents of the bag, the budget, and since 1760 the term has been in general use. In England it still means the Chancellor's statement of the nation's finances. On the Continent, however, the term budget has broadened into a wider meaning, and refers rather to the forecast of the government's next annual income and outlay, as well as to the legislative authorization of both.[1] Broadly speaking, budgetary legislation embraces the annual legislative appropriations as well as the statutory provisions for raising public revenue, whether such provisions be permanent or annual.

To trace the historical emergence of the budget in

[1] Stourm, Le Budget, p. 4, defines the term thus: "Le budget de l'état est un acte contenant l'approbation préalable des recettes et des dépenses publiques."

various lands would take us too far out of the channel of our present quest.[1] But in general, the tale is largely the story of the triumph of constitutional government; and as that goal has been successively neared by various peoples, certain financial usages have been established, common to them all. Such are the popular control over taxation through representative legislatures, the 'earmarking' of the sums accorded to the government, specifying the particular purpose for which alone these sums may be lawfully expended, the audit of the government's accounts so as to eliminate fraud or illegality in expenditure, and an increasing degree of publicity in the public book-keeping. It goes without saying that this progress has been more rapid in some countries than in others. Since 1688 budgetary constitutionalism may be regarded as matured in England. The American colonists carried with them to the New World this part of the British constitution. They vindicated it against aggression in the Revolutionary War, and embedded it in their fundamental law.[2]

France was the next nation to establish the modern budgetary system. Richelieu had typified the financial régime of absolutism in his *mot* that the public finances should be kept from profane eyes, as finances were the nerves of the state. To publish them were an indecent ex-

[1] See p. 23.

[2] Article I, Section VII, 1. All bills for raising revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments, as on other bills.

Sec. VIII, 1. The Congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States.

Sec. IX, 7. No money shall be drawn from the Treasury but in consequence of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published from time to time. —*U. S. Constitution.*

posure. In accordance with this idea the parliament of the realm was summoned so infrequently that their right to grant taxes to the crown was almost forgotten. The last of the "*réunions intermittentes*," as Stourm[1] calls them, of the Estates General had taken place one hundred and seventy-five years before, when in 1789 parliament was again summoned, and instituted the Revolution. Out of that convulsion the new financial order arose, and though dormant during the sway of Napoleon, revived under the successive governments that have since existed in France. The ferment of the French upheaval penetrated central Europe, and gave rise to the revolutionary struggles of the middle of this century, and though Bismarck[2] from 1862 to 1866 dared to set at naught constitutional government in Prussia, the nominal adherence to that régime and its proximate realization since 1848 have prevailed everywhere in Europe outside of Russia and Turkey. We are concerned, however, not with the historic process, but rather with the extant forms of budgetary legislation under advanced democracies, and may begin with the description of our own system.

The Federal Budget in the United States.—Almost all comparisons of our political institutions with their analogues abroad require some reference to our peculiar allocation of powers to the federal government and to the commonwealths respectively. Our independent state governments, sovereign within the bounds prescribed by the federal Constitution, give rise to a double financial network as well as to a double legal network covering the same territory. Our commonwealths are at liberty to raise what money they will and to spend it

[1] Le Budget, p. 25.

[2] Bismarck raised taxes for military purposes in defiance of the Landtag, but, after his victory over Austria, secured legislative amnesty.

practically as they choose, without let or hindrance from Washington. Their revenue and expenditure hang in no way upon the federal authorities. Each commonwealth, with the local units of government it founds and fosters, has its own budget. A fundamental severance of our federal budget and our state budgets is thus decreed. In Great Britain the relation between the central and local governments is, in legal theory, the very reverse of ours. The local governments in England depend for their very being on Parliament. Practically, as we know, a vigorous system of local self-government, unhampered save when obvious abuse of power is attempted, exists in England, but local expenditure and taxation are warranted annually by parliamentary act, and the divorce between the imperial and local budgets is by no means absolute as with us. While, therefore, local revenues and taxation in England are tacked to the imperial budget in its final form, the coalescence of the two is rather forced than organic, and, we might almost say, serves no particular end except that of statistical completeness. Our American budgetary system must be studied, therefore, first in the budget of the central government, and afterwards in those of the commonwealths and the local units of government.

First in order comes the federal budget. The starting-point in the description of our federal budgetary legislation must be made in scrutinizing the annual estimates of probable expenditure for the coming year. Congress upon assembling early each year in December receives from the Secretary of the Treasury an estimate of appropriations required for the fiscal year which is to begin on the first day of July next following. This rather formidable collection of figures is entitled a "Letter from the Secretary of the Treasury," and is addressed

to the Speaker of the House of Representatives. In this voluminous document the various departments of the government are taken up in order, and the particularized objects of expenditure under each department are set forth in minutest detail. Opposite each subject of outlay are placed in parallel columns the statutes which authorize expenditure for such purposes, the amounts *estimated* as necessary for such objects during the financial year next to ensue, and a statement of the amounts *actually* appropriated thereto for the current year. A comparison of the last two columns renders easy at a glance any change, whether of increase or decrease, which the Secretary ventures to propose. The figures are summed up under each main head, and the final summation gives the total amount which, on the face of the matter, must be spent to keep in running order the federal machine for the next financial year.[1]

However, it would be a mistake to take the Estimates too seriously, or to imagine that they embody the sum of the financial wisdom of the Secretary of the Treasury even in the matter of needed expenditure, or to suppose that, even if they did, they would thereby commend themselves to Congress. In the first place, it appears that these imposing tables of figures are prepared by the various departments beginning their several tasks shortly after July 1st of each year. The bureaus proceed upon the basis of their current needs to guess at their probable needs for a financial year not to begin for twelve months to come, and not to end until almost two calen-

[1] It often happens that, later on in the session of Congress, supplemental estimates, called Deficiency Estimates, will be sent in by the Secretary, specifying various objects for which the authorized appropriations for the current year are not adequate. The financial year of the United States government, it must be borne in mind, runs from July 1 to July 1.

dar years after the time when work on the Estimates is first set on foot. Manifestly, the chances for error are not small. By October 1st each department must have handed in to the Treasury its lists of figures. Thereupon the Secretary proceeds to digest and combine the partial reports, but even here his discretion is bound by hard and fast rules of procedure laid down for his observance. He may not say to the War Department, "Your estimates for needed expenditure upon rivers and harbors are extreme; cut them down." But embodied they must be in the Estimates. Not only expenditures already authorized by law must be included in the Estimates, but certain *probable* expenditures for public works for which the public surveys have been legally provided must be included. Equally wooden is the rule requiring an arbitrary sum to be placed in the Estimates for redeeming a part of the principal of the government debt, irrespective of whether there is likely to be any sum available for the Sinking Fund after current expenses have been met.[1] The extreme artificiality of the Estimates is shown in the Secretary's annual Report on the State of the Finances rendered each December, where with free hand he sets forth the probable governmental income and outgo for the coming financial year without concerning himself about harmonizing these figures with the totals of the Estimates. In this latter report, which appears in the public prints about the

[1] Section 3689 of the Revised Statutes provides annually an appropriation "of one per centum of the entire debt of the United States, to be set apart as a sinking fund for the purchase or payment of the public debt," but specifies that this appropriation must come "out of any moneys in the Treasury *not otherwise appropriated.*" Manifestly when current expenses absorb the current Treasury income, the source of the sinking fund appropriation is dried up. Notwithstanding the prospect of a deficit, the sinking fund appropriation figures in the Estimates year in and year out.

same time as the President's Message, the Secretary not infrequently takes occasion to discourse of financial reforms and a far-reaching financial policy. The report perhaps gains the ear of the public, while the Estimates, soon buried in the committee rooms of Congress, serve as a sort of actuarial basis, of no binding force, however, for the first rough draft of the various appropriation bills. Before following the Estimates to their last resting-place, the congressional committee rooms, it will be needful to say a word about the committees themselves.[1] The vast amount of work devolving upon Congress led to the early introduction of a committee system for which the colonial legislatures offered models ready to hand. The House of Representatives almost from the beginning, and the Senate as early as 1816, designated small subdivisions of their members as standing committees, charged with the special investigation of particular questions. Upon these special topics the committees drew up various bills which they reported in turn to their respective houses for discussion and eventual enactment. In its essence the system of committees was a labor-saving device. They were designed originally only to *inform* the larger body, and suggest an intelligent basis of departure in the matter of legislation. But in various ways the functions of the committees were enlarged, and their early duty of enlightening the houses became speedily the power of dominating legislation. Each within its particular province, instead of confining itself to the modest rôle of suggestion, began more and more to assume the tyrannical rôle of dictation. This change came about, owing mainly to the increasing pressure

[1] For the committee system and the rôle it plays in actual legislation see Woodrow Wilson's Congressional Government; Bryce's American Commonwealth, chapters XV, XVI, and XVII; and McConachie's Congressional Committees.

put upon Congress by our rapidly growing population. Interests multiplied with such amazing rapidity that to keep pace with them Congress was obliged to create a constantly increasing number of committees, each charged with the oversight of a new legislative province. The growth of the two houses themselves, as additional senators and representatives were admitted from the newly erected states, cut down the time that each committee on the average had hitherto been able to command of the attention of the whole body. Thereafter Congress was forced to pass many bills with little general debate, or to decline to pass them at all. This pressure upon their time was much more severely felt by the House of Representatives than by the Senate. The latter body was smaller numerically, and could await bills for raising revenue which must originate in the House. The committees, therefore, never attained the easy and almost undisputed sway in the Senate which they exercise in the lower body. Whereas the House cannot take the time to elect the members of its fifty-seven standing committees, but has deputed this virtual power of shaping legislation to the Speaker, the slower method of selecting committees by party caucus still prevails in the Senate. The House, moreover, had speedily to devise means for cutting off general discussion, whereas the Senate still adheres to its more leisurely system of unlimited general debate. In short, the process took such a trend that measures of secondary importance could frequently not obtain a careful examination in the full House, and therefore, if passed at all, were likely to be passed in the shape into which they had been thrown by the committee reporting them. The creature had become the virtual creator.

It would, however, be a mistake to imagine that the

various committees of the House are on a plane of equality. Manifestly, the eminent gentlemen charged with the matter of properly ventilating the capitol could hardly magnify their office, even if so disposed, to a parity with the Committee on Appropriations. The greater or less importance of the matters intrusted to the committees clearly distinguishes the committees as of superior and inferior grades. This difference is, as it were, an intrinsic difference. But the more powerful committees were not slow in arrogating to themselves a seemingly artificial grant of power by acquiring a preferred claim on the time and attention of the House. Certain privileged committees under the Rules of the House were allowed the right of reporting their measures at any time. The lesser committees could be rudely pushed aside, much as a poor purchaser in a shop might be left to wait with his bargain half completed, while an obsequious clerk rushes up to serve a moneyed customer. If the House had plenty of time at its disposal, this right of way possessed by the more influential committees would serve only to delay the business of the minor committees so summarily displaced. But the enormous demands on the very limited time of the House mean not only vexatious delay, but more often obscurity and defeat for the measures fathered by the inferior committees or introduced by members in their private capacity.

The privilege of reporting at any time, once the precious monopoly of some four or five committees, was long viewed with jealous eyes, and was finally seized and shared by numerous other committees.[1] Still the committees so privileged are but sixteen in number.

[1] Section 57 of Rule XI of the House of Representatives gives a list of committees having leave to report at any time.

The value of the privilege declined as the privilege became more common, but upon the plane of equality which the more powerful committees had asserted for themselves that 'dignified oligarchy' called the Committee on Rules has latterly erected its throne. With a membership of but five, and with the Speaker as chairman, this dominant committee may map out, as it will, the time of the House, and determine the subject-matter for legislative consideration. Furthermore, where the Speaker associates with himself upon the Committee on Rules the chairmen of the Appropriations Committee and the Committee on Ways and Means, he has formed a small but efficient "steering committee" whose large power is the signal feature of the House as now organized.[1]

It hardly needs to be said that the committees on finance have always been regarded as the most important committees in Congress. Temporary issues, such as war, may elevate for a time upon the same high level other standing committees, such as those on Foreign Affairs, but their little day is soon over, and while in the committee hierarchy the Foreign Affairs, especially in the Senate, stands high, its importance is potential rather than actual. Treaties and conventions are of prime importance, but they are not negotiated every year. But no month passes without the necessity for raising and spending revenue, and the committees whose fingers first fumble the public purse-strings have a substantial primacy among their fellows which cannot be questioned.

The history of the financial committees of Congress is in the main a history of how overburdened commit-

[1] See Follett, The Speaker of the House of Representatives, pp. 274-289.

tees have surrendered, often unwillingly, tasks of ever-growing complexity. In the House of Representatives the Committee on Ways and Means from its creation in 1802 until March 1865 had control not only of measures affecting the public debt, but of bills for raising as well as for expending money. Up to 1828 appropriation bills were only three in number each session,[1] and not until 1844 were the appropriation bills multiplied beyond that number. In 1865 the Committee on Ways and Means, staggering under the enormous mass of legislation resulting from the Civil War, was relieved of the work of preparing and reporting appropriation bills. Thereafter the work of raising the government's income was intrusted to one set of men, and the work of spending that income to another set. The character of the Ways and Means Committee since 1865 has changed radically. Shorn of exclusive control over the domain of finance, it no longer attempted to essay its earlier rôle. During the first four decades of the Constitution it had reported thirty-eight measures for raising revenue and thirty-eight appropriation bills. But virtue had gone out of it. It began after 1865 to repel changes in the tariff system, and was put, as it were, on the defensive. In recent years it has remained the engine whereby changes in the federal tax system have been at intervals attempted by the two great parties. Its preponderating importance is due perhaps not so much to its annual legislative activity, as to its being the workhouse in which the great tariff measures have been forged which first in the congressional arena and afterwards before the people have been fought out in successive political campaigns.

[1] Congressional Record, Dec. 15, 1885, p. 199. McConachie (p. 176, *op. cit.*) asserts that in 1837 the Rules enumerated four

But while revenue laws may be framed capable of enduring for a number of years, appropriation laws must be passed each session. While the Ways and Means was left to enjoy a nominal though often an empty preeminence, the Committee on Appropriations became possessed not merely of the shadow of power, but of its substance. Inheriting from its predecessor the prerogative, then rare, of reporting at any time, the Appropriations Committee at one period almost monopolized the time of the House, and controlled with a high hand the expenditures of the government. But its humiliation was not long in coming. The sweets of dispensing money from the federal treasury proved too great a boon for the other committees quietly to forego, and they openly revolted against the tyranny of "the white-button mandarins of the Appropriations Committee." First the power of reporting the River and Harbor bill was wrested from that committee in 1879. Then the Agricultural Appropriation bill was extorted from their grasp. Other aspiring committees demanded and obtained equal privileges of reporting to the House at any time. By 1887 eight different committees had secured the power to draft and report appropriation bills for various objects, and to-day only six of the thirteen annual appropriation bills are under the control of the once dominant Committee on Appropriations.[1]

general appropriation bills; but (p. 175) that "for the first forty years of the nation's history appropriations were in the main confined to one regular annual law."

[1] The Committee on Appropriations prepares bills for (1) legislative, executive, and judicial expenses; (2) for sundry civil expenses; (3) for fortifications and coast defences; (4) for the District of Columbia; (5) for pensions; (6) for all deficiencies. See Rule XI, section 3, Rules of the House of Representatives. The other appropriation bills are the Army and the Military Academy bills; the appropriations for Agriculture;

The work of the financial committees of the House of Representatives may be summed up as follows: Bills for the raising of revenue are drafted by the Committee on Ways and Means, not annually as a general rule, but once every three or four years, unless some exigency like war requires more frequent action. The spending of money is initiated by appropriation bills drafted by eight independent committees and passed annually. Besides the annual appropriations there are certain permanent appropriations made in virtue of statutes that run without date or until they are repealed. The permanent appropriations [1] provide for the interest on the public debt and for various other objects of lesser importance, including the Sinking Fund.[2] In the aggregate the authorized permanent appropriations amount to about one fourth of the total expenditures. The several appropriation bills are reported to the House in committee of the whole. The time for their discussion is limited, not infrequently by a special rule made *pro hac vice*. Amendments may be offered, but only such as are offered by the chairman of the committee reporting stand much chance of being accepted. Other amendments are swept ruthlessly aside, and are generally voted down after the briefest debate. At the close of the few hours allotted for the discussion of the measure the vote is taken; and after a perfunctory ratification by the House of the decision of the committee of the whole House on the state of the Union, the measure is passed on to the Senate for acquiescence, rejection, or amendment.

Financial legislation in the Senate runs much the

for the Diplomatic and Consular service; for the Indians; for the Navy; for the Post-office; and for Rivers and Harbors.

[1] See sec. 3689 Revised Statutes.

[2] See page 350.

same course as in the House, except that the smaller size of the Senate allows a more extended debate, if senators choose to exercise their prerogative of unlimited talk. The constitutional right of the House to originate bills for the raising of revenue does not prevent the Senate from exercising an almost unlimited power of amending financial measures. Before 1867 the Senate Committee on Finance had powers similar to those of the primitive Ways and Means of the House, and controlled measures affecting both the raising and the spending of money except money devoted to the Rivers and Harbors bill, which had become the prey of the Committee on Commerce. In 1867, however, the Senate Committee on Appropriations was created, and dispossessed the Committee on Finance of its work of considering appropriation bills. Even the disintegration of the Senate Committee on Appropriations is now mooted, but at present the three committees named above have initiatory control of such financial measures as reach the Senate. The Senate not only amends with great freedom such measures as come up from the House, but commonly increases the amounts appropriated to various objects. This necessitates a compromise between House and Senate. The former generally votes to nonconcur *in toto* with the Senate amendments. A committee of conference is appointed consisting of an equal number of senators and representatives. An agreement is generally devised by the conference committee, based on no very logical plan except the substitution of a rough average for the divergent amounts named in the original and in the amended measure. The conference report is quickly railroaded through the House as a matter of the highest privilege under the Rules, and is generally accepted by the Senate as the best it can get under

the circumstances. It then runs the gauntlet of the executive veto, and escaping that, becomes the law of the land.

Appropriation bills, however deficient they may be in other respects, are not lacking in this,—that they specify with great minuteness the objects for which particularized amounts may be expended by the departments of the government. Alexander Hamilton was probably the only Secretary of the Treasury who ever received free hand to spend the moneys appropriated by Congress, provided only he did not exceed the total amount authorized in the single paragraph that constituted the first congressional appropriation law. Amounts appropriated to any purpose which in whole or part remain unexpended after two years become no longer available for such purpose, and are covered into the Treasury's cash. The Treasury is provided with elaborate auditing machinery to see that no money leaves the Treasury except under due sanction of law. The same machinery examines the vouchers and receipts of the various departments to see that the government's cash has actually been received by those who are mentioned in the departmental reports. And Congress finally has numerous committees charged "with the examination of the accounts and expenditures of the several departments," though, it is to be feared, these committeemen generally regard their duties as little more than sinecures,—a view which the mean status of these committees probably reflects.

The Imperial Budget of Great Britain.—Partly with a view to assessing its intrinsic value, and partly to afford a basis of comparison with our own financial system, an account, though brief, of the budgetary legislation of the British Parliament may here be given. There as here,

the process may best be approached by first glancing at the Estimates of expenditure. The financial year in England runs from April 1st to April 1st. In November of each year the various departments of the government make up their preliminary estimates of expenditure required for the year beginning on the first of the following April. These tables are presented to the Treasury, whose head is the Chancellor of the Exchequer. That functionary, if report may be believed, is allowed in digesting and combining the partial estimates a latitude which our rigid statutes do not permit the Secretary of the Treasury to exercise. The Chancellor may question the calculations made by the heads of the other departments. He may challenge the necessity of the expenditure for which they vouch. He may even make a colleague's refusal to acquiesce in the Treasury's pointed suggestions the occasion of a family row in the cabinet until the matter is adjusted to that select body's satisfaction. When, finally, the Estimates are whipped into such a shape that they meet the approval of the Chancellor and the cabinet, the figures are presented to the House of Commons, upon the collective responsibility of the cabinet and with its official approval. The Estimates are submitted all at one time in three grand divisions, called respectively the army, the navy, and the civil-service estimates. Each grand division is broken into sections, technically called "votes," of which there are from ten to twenty each in the army and navy estimates, and about eighty in those for the civil service. No member of Parliament other than a cabinet minister may propose any "motion which in any way creates a charge upon the public revenue."[1] The matter is now

[1] Cf. May, Parliamentary Practice (edition of 1893), p. 527 *sq.*

ready for legislative consideration. For purposes of informal discussion the House of Commons resolves itself into a committee of the whole, and before the whole House, sitting in the capacity of Committee of Supply, the Estimates are presented, explained, and defended by the Chancellor of the Exchequer. He is subjected to a running fire of questions and criticisms. The wisdom of his proposed expenditures may be denied by the Opposition. They may propose to cut them down, or may even refuse to grant them outright. But no one but a cabinet minister may propose their augmentation, and a serious rejection of proposed expenditures would precipitate the resignation of the cabinet, perhaps the dissolution of the House. Item by item, the proposed expenditures are sanctioned from time to time by the Commons sitting as Committee of Supply.

But these votes of approval do not suffice to unlock the doors of the public chest. They are but a preliminary assent to expenditure for various objects named in the Estimates. To secure the money wherewith to defray the expenditures warranted, a second round of parliamentary approval must be secured. For this purpose, to wit, of providing ways and means to meet the expenditures already sanctioned, the House resolves itself into a Committee of Ways and Means. This in Parliament is not a small committee as with us, but simply the whole House sitting informally as a large committee for the business in hand. Step by step, it is moved to make grants out of the Consolidated Fund[1] to provide for the services previously voted in the Committee of Supply. No motion can be made in the Committee of Ways and Means to impose a tax for the purpose of

[1] The Consolidated Fund is a technical expression for the sum total of the public revenues.

raising revenue, "save by a minister of the Crown, unless such tax be in substitution, by way of equivalent, for taxation at that moment submitted to the consideration of Parliament."[1] After some progress has been made in providing revenue to meet the various expenditures already allowed, the Chancellor of the Exchequer, generally a few days after the beginning of April, makes his budget speech, ordinarily in the Committee of Ways and Means. In the budget he reviews the nation's finances for the year just closed, and concludes by proposing certain measures of taxation for the current year. Ordinarily these embrace the proposed rate of the income tax and the duty on tea, as these two taxes alone are fixed annually instead of once for all. As the Committee of Ways and Means agrees from time to time to the various resolutions there presented, such resolutions are shaped in the form of bills and sent up to the House of Lords for their approval, which generally follows as a matter of course. These bills, therefore, when the Crown has formally assented to them, become laws which authorize the government to expend money for its immediate needs. When finally all the grants necessary for the year have been made, and the Committee of Supply has ceased to sit, the various partial grants are recounted and summed up in the so-called Appropriation Act, which provides for the entire year and is passed in the Committee of Ways and Means generally just before the prorogation, or temporary adjournment, of Parliament. In short, the process of financial legislation in England consists first in sanctioning *seriatim* certain proposed expenditures for certain definite objects. This process takes place from time to time in the Committee of Supply. Then an analogous

[1] May, Parliamentary Practice, p. 532 *sq.*

process of granting out of the Consolidated Fund certain amounts or 'credits' follows. These 'credits' sanction expenditure only for the time being. Finally, when the Estimates have been adopted, the various temporary grants of money are summed up and completed by being increased so as to cover the expenses for the entire year.

In England, as in the United States, there are certain permanent appropriations which are not voted annually by Parliament. These permanent appropriations are a first lien or charge upon the Consolidated Fund, and amount to about three eighths of the total amount expended annually. Besides embracing the interest on the public debt, these standing appropriations cover a rather motley collection of items, such as the Crown's salary (called the civil list), as well as the salaries of the judges of the realm, of the Speaker of the House of Commons, "of the porter of Holyrood House, of the perpetual curate of the Isle of Alderney, and of the Regius Professor of Civil Law in the University of Oxford,"[1] and other miscellaneous items. It must be noticed that the House of Lords occupies no such position of importance in matters of finance as our Senate asserts for itself. Whatever the precise constitutional status of the Lords may be, as a matter of fact they seldom refuse to acquiesce in the financial bills of the Commons, and generally without any substantial attempt to amend or alter the terms of such measures.

The process of audit and control of expenditures is in the first instance in the hands of the Auditor and Controller-General, an official whose salary is guaranteed out of the permanent appropriations, and whose independence both of Parliament and the executive de-

[1] Anson, Law and Custom of the Constitution, p. 322.

partments is assured. He examines the statutes appropriating money, and unless convinced of the legality of any proposed departmental expenditure he may prevent the departments from touching a penny. The government's money is on deposit in the Bank of England, and can be drawn upon only when the Auditor-General signs the orders upon the Bank. The same official is charged with examining the vouchers and receipts of disbursements, and must report any irregularity he discovers to Parliament. Money appropriated by Parliament must be expended within the financial year for whose service the money was voted. Unexpended balances cannot thereafter be used for another object even in the same executive department.[1] At the close of the financial year the reports of both the Auditor and the departments are scrutinized by a Public Accounts Committee of the Commons, who have thus a final chance to re-check and verify the correctness of the government's financial reports.

Viewed from the standpoint of financial technique, the English system of financial procedure is admirable. The Estimates gauge very closely the actual expenditures incurred. Thus from 1889 to 1892 the Estimates coincided within a minute fraction of one per cent. with the actual expenditures.[2] They are evidently framed with a view to economy, as the small deficiency appropriations prove; and, best of all, the almost despotic control exercised by a single committee, the cabinet, secures

[1] An exception of trifling moment exists in the War and Admiralty departments, where sums saved out of temporary grants may be applied in case of necessity to other purposes in the same department, provided the total expenditure authorized be not exceeded, and a report of the transfer be laid before parliament.

[2] Bastable, Public Finance, p. 691, note.

almost invariably in normal times an equilibrium between income and outgo.

Comparison of American and English Methods of Budgetary Legislation. — The brief outline which has been given will serve as a basis for the comparison of our methods of budgetary legislation with those in vogue in England. Such a comparison must involve much more than a mere contrast of financial technique, for the differences in the two systems spring out of underlying differences in political structure, and a purely didactic treatment of the subject issuing in a verdict of the superiority of either must be highly superficial. Fundamentally, the characteristic feature of the English financial system rests upon the coalescence of executive and legislative powers in the English cabinet. The unique features of our system root themselves in our complete severance of the law-making and law-administering powers. Under our Constitution there is no guarantee that the President, the Senate, and the House will all be of the same political complexion. As a matter of fact one of the three is commonly at variance politically with the other two. Laws that meet the approval of the three must of necessity partake more or less of a compromise character. The clear-cut policy which naturally results when the heads of departments as in England are themselves the parliamentary framers of the laws they afterwards execute cannot be secured under our system of government. Each plan of government has its drawbacks as well as its advantages. But it is futile to suppose that either will eventually prevail in both countries. The growing power of the Speaker of our House of Representatives has served to give some coherence to the bills enacted by that body. It has un-

doubtedly chained the elements in the House that made for chaos. But that the Speaker, or a steering committee of both House and Senate will eventually develop into something analogous to the English cabinet seems practically impossible. Nor is any very perceptible progress making in England toward our type of government. Indeed many of the comparisons of the respective merits of the two plans of government are defective in this, that they neglect the difference in conditions prevailing in the two countries. England is geographically compact, and practically homogeneous. Her political habit is all of one color. Her life, industrial and social, is reasonably stable. Unity and coherence of political policy and action put no severe strain upon the English body politic. Our social and political life, on the contrary, is as yet one of growth and movement, and the question may with reason be entertained whether a frame of government too loosely hanging to be trim may not after all be best for us, as not impeding the free play of our activities, or putting in duress elements most safe when unconfined. The Fathers, as we fondly term them, were doubtless guarding against a visionary danger when they devised our constitutional system of 'checks and balances' to avert the tyranny of any part of the government. They could not foresee the growing force of public opinion which, of itself, would be able to-day to shatter the kind of tyranny they most dreaded. But in a way they builded better than they knew. The safeguards which they devised against usurpation have proved the bulwarks of political conservatism. The impossibility of sudden and far-reaching changes which the separation of powers effected has redounded not a little to our political safety. Were sweeping changes of policy possible with us, national

unity and concord might have been endangered. And so in finance as elsewhere, if our system has sacrificed unity and harmony of arrangement, it has at least contributed to make our process of national growth, not frictionless, to be sure, but reasonably safe.

Viewing the matter from a closer and narrower standpoint, the technical excellences of the English system over ours become more manifest, but even the legislative manipulation of finance reflects more than one difference in the phases of our respective political systems. In Parliament the salient fact is leadership; in Congress, equality. Leadership of some kind there must be under any system, of course. But if in the Commons the cabinet is thought to be leadership made perfect, in our House of Representatives the same régime would be rejected as tyranny unbearable. The Speaker of our House exercises the power of a leader, not merely that of a moderator. But his power is not the same in kind as that of the cabinet in the Commons. The Speaker's power is after all a power of reasonableness—not always of 'sweet reasonableness' it may be, but of reasonableness after all. None know better than the eminent gentlemen who occupy our Speaker's chair when they must insist upon and when they must yield their individual preferences. It is our Speaker who brings upon the provincial congressman the pressure of national interests. Doubtless these "counsels of perfection" are often cogent and unanswerable appeals made privately in the interest of the party which the Speaker and the member from Buncombe serve both day and night, but the glove of velvet is to be found in the arrangement as well as the hand of steel. Moreover, it may be surmised that our Speaker's real power of control chafes the less because it is not exercised in petty matters of detail. The

Committee on Agriculture may be advised to be 'easy on the Treasury,' but the Speaker does not 'blue-pencil' the bill which the committee frames. And while the Speaker's rewards and punishments consist in the committee berths at his disposal, he may not threaten recalcitrant members, as the English cabinet may, with the speedy risk and expense of a new election. On the other hand, the cabinet stands to the Commons in quite another attitude. Here are the proposals for raising and for spending money. They must be fully explained to the House, at least as fully as such enormous sums and their details can be explained in the committee sittings. Additional expenditures may not be moved except by a minister of the Crown, nor proposed appropriations increased. If the supplies are refused or seriously cut down, the cabinet—and generally with unnecessary verbiage savoring a little of hypocrisy—tells the Commons in effect that another cabinet must be selected, or perhaps that the bore of a general election must be endured. Even if another cabinet be put in power, it is but a change of masters. The new ministers will affect the same horror at having profane hands laid on their sacred Estimates.

Now it is not to be denied that the English system of cabinet government is most admirably contrived for securing consistency and unity in financial arrangements. Charging the same set of men with determining the extent of expenditure, and with providing the necessary revenue, is admirably adapted to secure budgetary equilibrium. Income equals outgo. Moreover, if Tom, Dick, and Harry were at liberty to saddle new items of expenditure upon the government, this annual balancing of accounts would be rendered impossible. The English system may also be credited with enforcing economy. Raids on the Exchequer cannot well be made when the

"log-rolling"[1] system is shut out by the Standing Orders of the Commons. All this is undeniable. But the point upon which we are now insisting is that the machinery of *legislative suppression* which permits this in England would be summarily smashed if set up in Congress, and that, too, because of the dominant notion of equality which our representatives believe in and maintain.

Moreover, there are some compensating features about our system, extravagant and inharmonious as it often is. If precision in securing equivalence between income and outlay is sacrificed, our system of many committees does allow a very large number of our legislators to become personally acquainted at first hand with the real needs of the various governmental departments. The combined membership of our appropriation committees makes up no inconsiderable fraction of the entire House of Representatives. Certainly, more than a quarter of the whole House have the opportunity of learning the financial needs of the various public services. And this is no small gain. Moreover, it must be admitted that our congressional experience of intrusting to a single committee the preparation of all the appropriation bills was far from reassuring. The natural tendency of each committee to be lavish in recommending expenditure for the province which it controls has been counteracted in part by the committee's more intimate knowledge of the real as opposed to the fictitious needs of such subdivisions of the federal service, and in part by the restraint exercised by the Speaker over all the committees. The Appropriations Committee, before it was shorn of its vast powers, used its prerogative not only to pass its

[1] "Log-rolling" is an epithet applied to our congressional practice where congressmen agree to support one another's proposed appropriation bills.

own measures, but to block any other measure—financial or otherwise—of which it disapproved. Moreover, the hollowness of its plea that a single committee could better oversee expenditure as a whole than could a number of committees was disclosed by the fact that the work of preparing the various appropriation bills was turned over by it to small sub-committees of its own members.[1] Even on the score of economy the English system is perhaps not so complete a preventive of extravagance as is sometimes imagined. The meaning utterances of more than one Chancellor of the Exchequer indicate that, notwithstanding the cabinet's prerogative of proposing new or increased expenditure, individual members may bring such pressure to bear on members of the cabinet that the Chancellor of the Exchequer is forced to accede to such demands, and to foist them upon the official Estimates.

Had our federal finances been managed for the last thirty years solely with a view to budgetary equilibrium, it must be granted that the successive series of surpluses and deficits realized would prove its condemnation. But it must be remembered that the federal finances have had to regard, whether wisely or not, the maintenance of our system of protection. The double task of maintaining

[1] "How do they [i.e. the Appropriations Committee] audit the accounts of this country? Why, they appoint sub-committees, each of which has charge of a particular bill. And how many of the gentlemen, outside the sub-committees, have you seen discussing this audit in the face and eyes of the House of Representatives? . . . In other words, these gentlemen of the Appropriations Committee do this very thing which they think the House of Representatives cannot be trusted to do: they parcel out the auditing to small committees of their own. . . . Hence I say there is an immense advantage in having this House thoroughly informed as to the affairs of the country by increasing the number of men who will know something about these subjects."—T. B. Reed, Cong. Record, Dec. 15, 1885, p. 199.

that system inviolate and, through the same means, of providing requisite revenue has stood in the way of securing equilibrium. Moreover, it may prove that, whatever our future tariff policy is to be, we shall be chary about frequent changes in the sources of federal revenue. If this happens to be the case, the establishment of annual equilibrium of income and outlay may have to be given up, and plans devised for regularly meeting deficits with temporary loans,[1] and disposing of surpluses by applying them to the reduction of the national debt.

At all events we may easily congratulate ourselves upon the superiority of our financial system over the French system. There the Estimates are made as in England by the cabinet ministers. They are then turned over to the tender mercies of the *Commission du budget*. This body, consisting of thirty-three members of the Chamber of Deputies, does not hesitate to reshape the Estimates as it will, generally by adding large additional appropriations. When the appropriations have been sanctioned by both Senate and the Chamber of Deputies, they betray nothing less than a hodge-podge of ill-digested measures whose only predictable outcome is an annual deficit. Permanent appropriations do not exist in France, so that even the interest on the public debt is provided for only from year to year by legislative act. Credits accorded various departments do not lapse, and the final accounts of any financial year are not rendered until several years have passed. In striking contrast to the French method of voting all appropriations annually is the Septennate in Germany, where military

[1] The Act of June 13, 1898, empowers the Treasury to emit certificates of indebtedness, not to exceed $100,000,000 in the aggregate, and maturing not later than one year from their issuance, in order to meet a temporary deficit.

appropriations are voted for a term of seven years at a time. If the French plan is bad policy financially, the German plan betrays an equally weak legislative control over the public purse.

State and City Budgets.—Obviously, no complete outline of the budgetary legislation of American commonwealths and cities could be attempted which faltered at an infinitude of detail. But of the state legislatures it may be said in general that they shadow forth, though rather dimly, the same financial procedure as is found in Congress.[1] The financial powers of the state legislatures have been curbed by repeated constitutional amendments, limiting the duration of their sessions, the use they may make of the state credit, and frequently the rates of taxation they may impose. In the states, the State Auditor or the State Comptroller, occasionally the Secretary of State, prepares what corresponds to the Estimates laid before Congress by the Secretary of the Treasury. These Estimates furnish the framework upon which the financial measures of the various states are based by the several financial committees. Not uncommonly the system of permanent appropriations exists which determines, as it were, automatically, the fraction of the total revenue which must be assigned to each specific object. It is significant, too, of the growing financial powerlessness of the legislatures, that it is in the older states chiefly where this standing allocation of certain fixed portions of the total revenue to particular purposes prevails. Though the various departments may not be able to draw upon the public money until the yearly sanction of the legislature has been accorded, still that sanction is

[1] See Annals of the American Academy for 1896, art. by E. L. Bogart, Financial Procedure in the State Legislatures.

only the registration of the legitimacy of the public spending, rather than a substantial exercise of an unhampered legislative right to vote supply. Moreover, when the state legislatures do exercise their residual power to appropriate money for other purposes, these bills or even their objectionable sections may be vetoed by the governor. In American cities the tendency has of late prevailed to take away from councils or boards of aldermen the fixation of expenditure, and to intrust this power to commissions or small bodies of administrative officials. Thus in New York City (even before the adoption of the new charter) the Board of Estimate and Apportionment exercised the real power of deciding upon appropriations.[1] Evidently the whole business of city government in the United States is in such a chaotic state of transition that it is almost impossible to portray the typical budgetary procedure of the American city.

[1] See E. D. Durand, Finances of New York City; Municipal Affairs for June 1898, art. by A. W. Foote, Uniformity in Municipal Finance; Municipal Affairs, Dec. 1900, art. by M. R. Maltbie, Cost of Government in City and State; also art. by Frederick R. Clow in Publications of the American Economic Association, 1901, City Finances in the United States.

APPENDIX A.

THE war revenue act approved June 13, 1898, introduced the following changes in our system of federal finance:

(*a*) A duty of ten cents per pound was imposed upon all tea imported into the United States. Prior to this act tea had been admitted free of duty.

(*b*) The existing Internal Revenue system was altered; first, by increasing the rates of taxation upon certain articles, notably tobacco, cigars, and fermented spirits; second, by charging the Internal Revenue Department with the assessment and collection of a number of entirely new taxes. The tax on manufactured tobacco and snuff was raised to twelve cents per pound. The tax on cigars (weighing over three pounds per thousand) was raised from three dollars to three dollars and sixty cents per thousand. Cigarettes weighing over three pounds per thousand were taxed at the higher rate, while both cigars and cigarettes of lesser weight were taxed at a lower rate—one dollar per thousand for cigars, and one dollar and a half per thousand for cigarettes. Besides these taxes certain minor taxes were imposed upon dealers in tobacco.

The tax on fermented spirits—beer, ale, porter, and the like—was doubled and stands at two dollars per barrel (of thirty-one gallons), though a discount of 7½ per cent. is allowed on the purchase of the stamps used to indicate the payment of the tax.

(*c*) The distinctly new taxes created by the act may be classed as follows:

1. Taxes on certain commercial transactions or the papers and documents used therein.

2. Taxes on certain occupations and on specified kinds of business enterprises.

3. Taxes upon legacies and distributive shares of personal property.

4. Taxes on miscellaneous products.

Under the first division fall the taxes imposed upon the issue of certificates of stock or bonded indebtedness by any company or association; on all sales of stocks, bonds, and other securities; on bank checks, bills of exchange, deeds conveying realty, custom-house entries, insurance policies, leases, mortgages, passage tickets by foreign-bound steamers, as well as on telegraph and telephone messages, and seats sold in parlor-cars or sleeping-cars.

Under the second division are included the annual taxes imposed on bankers, brokers, the proprietor of any theatre, bowling-alley, billiard-hall, or circus. Here also we must class the taxes imposed upon the refiners of sugar and petroleum. These last-mentioned industries are taxed not an annual sum outright, but each a percentage ($\frac{1}{4}$ of 1 per cent.) of its gross receipts in excess of $250,000.

In the third sub-division will fall the tax imposed upon legacies and distributive shares of personal property. Such taxes are in addition to similar taxes imposed by the various commonwealths. Where the total value of the property passing by inheritance is under $10,000, or where the property (whatever its amount) passes directly from husband to wife, or from wife to husband, no tax is imposed; where the value of the interest involved is of greater amount than $10,000 the tax imposed is progressive, rising according as the inheritor is more distantly related to the deceased owner, and rising also as the

hereditary interest involved exceeds the exempted minimum of $10,000. The lowest rate of tax is seventy-five cents on each $100,—this, where the estate does not exceed $25,000 and the relationship between inheritor and decedent is closest. The maximum rate of tax is $15 on each $100,—this where the property passing by will or under the intestate laws exceeds $1,000,000, and the tie of blood relationship is most distant, or where the beneficiary is a stranger in blood or a body politic or corporation.

Under the last sub-division must fall the taxes imposed on a variety of miscellaneous articles,—mixed flour, medicinal and proprietary articles, perfumery and cosmetics, sparkling wines bottled, and chewing gum.

(*d*) The relative importance of these various taxes may be judged from the following estimate made by Mr. Dingley of their probable yield during the present fiscal year (1898–9):

Fermented liquors	$58,906,120
Tobacco and snuff	43,840,560
Cigars and cigarettes	17,340,382
Manufactures and dealers in tobacco	307,102
Bankers	2,394,600
Brokers (money and pawn)	1,500,000
Brokers (commercial)	213,094
Theatres and the like	1,820,447
Bowling-alleys and the like	166,967
Sales of bonds, stocks, and merchandise	10,000,000
Bank checks	5,000,000
Bills of exchange (inland)	1,500,000
Bills of exchange (foreign)	500,000
Express and freight bills of lading	10,000,000
Life insurance policies	1,226,323
Mortgages	2,041,599
All other articles in Schedule B (drugs of various kinds)	18,000,000
Proprietary medicines and perfumery	15,000,000
Chewing gum	1,000,000
Legacies and successions	9,275,475
Duty on tea	10,000,000
	$210,033,069

The net addition to the receipts of the Treasury from the Act of June 13, 1898, was estimated by Mr. Dingley at $148,481,306.

(*e*) The Act of June 13, 1898, besides enhancing or creating the taxes aforesaid, empowered the Secretary of the Treasury to borrow $400,000,000 for carrying on the war. The bonds issued bear interest at 3 per cent. and are redeemable at the pleasure of the United States ten years after their issue, and are payable twenty years after their issue. Besides issuing these bonds or such part thereof as is necessary, the Secretary of the Treasury is empowered by this act to borrow from time to time an amount not in excess of $100,000,000, and to issue therefor three per cent. certificates of indebtedness maturing not later than one year after the date of their issue. This provision confers upon the Treasury the power to meet a current deficit of moderate dimensions.

(*f*) Lastly, the law in question provides for a minimum monthly coinage of the seigniorage, or gain, arising under the purchases of silver made in accordance with the Act of July 14, 1890. The bullion so transformed into standard silver dollars becomes analogous to the silver dollars already existing. They may be paid out to any creditor who will receive them of the government, but inasmuch as the number of such coins in active circulation is limited by the commercial uses for such silver coins, it would seem that the greater part of such silver when coined will remain under present conditions in the Treasury vaults.

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